

**AUDIT OF THE
COMPETITIVE SERVICE OFFERINGS OF**

**SOUTH JERSEY GAS COMPANY
Docket #GA02020101**

**SUBMITTED TO THE
NEW JERSEY BOARD OF PUBLIC UTILITIES
DIVISION OF AUDITS**

**SUBMITTED BY
OVERLAND CONSULTING**

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List of Abbreviations

ADS	Automated Dispatching System
Affiliate Standards	New Jersey Administrative Code Section 14:4, Subchapter 5 - Affiliate Relationships, Fair Competition and Accounting Standards and Related Reporting Requirements
AirLogics	AirLogics, LLC
ASB	Appliance Service Business
BGSS	Basic Gas Supply Service
BPU	New Jersey Board of Public Utilities
CAM	Cost Allocation Manual
Conectiv	Conectiv Solutions LLC
EMI	Energy & Minerals, Inc.
Energy Solutions	South Jersey Energy Solutions, LLC
LGAC	Levelized Gas Adjustment Clause
Marina	Marina Energy, LLC
Millennium	Millennium Account Services LLC
MSI	Measurement Solutions International - Northeast, LLC
PUHC	Public Utility Holding Company
SJE	South Jersey Energy Company
SJG	South Jersey Gas Company
SJI	South Jersey Industries, Inc.
SJRG	South Jersey Resources Group, LLC

Chapter 1 - Executive Summary

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I. Introduction

This report describes the results of an audit of South Jersey Gas (SJG) Company's compliance with New Jersey Board of Public Utilities (BPU) rules, regulations and orders related to competitive services. The audit was conducted in the context of BPU dockets AA02020094 (generic) and GA02020101 (SJG). The BPU rules and regulations are codified in New Jersey Administrative Code Section 14:4, Subchapter 5 - Affiliate Relationships, Fair Competition and Accounting Standards and Related Reporting Requirements (Affiliate Standards). This chapter of the report describes the conduct of the audit, restates the audit scope and objectives, summarizes audit findings and documents audit recommendations.

II. Audit History, Scope and Objectives

This audit was conducted pursuant to a Request for Proposal issued by the BPU on March 20, 2002. Overland Consulting was selected to perform the audit and signed a contract in July, 2002. We issued our first data request to SJG on July 30, 2002. Our primary BPU contacts during the audit were Thomas Langbein, Bureau Chief, Management Audits, and Pasquale Salvemini, Bureau of Management Audits. Mr. Salvemini participated in the field work phase of the audit, including most interviews. Our primary Company contact during the audit was Richard Walker, Corporate Secretary & Corporate Counsel of SJG and South Jersey Industries, Inc. (SJI).

We conducted audit field work at SJG's Folsom, New Jersey headquarters from October 8, 2002 through December 20, 2002. In total, we conducted interviews of 15 SJI, SJI subsidiary and SJG employees covering a range of topics relating to affiliate transactions and compliance with BPU Affiliate Standards. A list of interviews is shown in Appendix 1. We conducted audit analysis from October, 2002 through February, 2003. In total, we issued 141 formal requests for data and information. A data request and response log for the audit is shown in Appendix 2. We submitted our draft report to the BPU on February 3, 2003.

The audit's scope, in accordance with the Request for Proposal, included a review of competitive services offerings and affiliate relationships and transactions. Audit objectives included a determination of the following:

- C Whether there is strict separation or allocation of utility revenues, costs, assets, risks and functions from those of its competitive service segments.
- C Whether the degree of separation is reasonable under the BPU's Affiliate Standards.
- C Whether there is cross-subsidization between the utility and competitive service segments.
- C The impact on ratepayers of using utility assets to provide competitive services.
- C The impact of competitive services on utility workers.

- C The impact of utility practices on the market for competitive services.
- C Whether recommendations from the previous audit have been fully implemented.

The period reviewed in this audit included SJG's fiscal year 2001 and the first nine months of 2002 (January 1, 2001 through September 30, 2002).

III. Audit Report Contents

The audit report is organized in accordance with SJI's corporate structure and SJG's affiliate relationships. SJG is the primary subsidiary of SJI, an energy services holding company. SJI's operations, services and transactions are conducted primarily within the following legal entities:

- C SJI, the parent company, contains an eclectic group of functions, including shareholder records, non-regulated accounting, marketing, and a non-regulated sales department. However, many of SJI's executive management team are treated as SJG employees. Audit findings related to SJI's and SJG's shared corporate services and associated cost allocations are discussed in Chapter 3.
- C SJG, the gas utility, distributes natural gas in southern New Jersey, makes off-system sales of natural gas on a wholesale basis, and transports natural gas purchased directly from producers and suppliers on its own behalf and on behalf of its customers. SJG had approximately 300,000 customers at the end of 2002.¹ In the last quarter of 2002, SJG had 605 employees.² SJG shares certain functions with affiliates. The cost allocations associated with these functions are discussed in Chapter 3. During the audit period, SJG also had an Appliance Service Business. SJG's compliance with the Affiliate Standards as it relates to the Appliance Service Business is discussed in Chapter 4.
- C Millennium Account Services LLC (Millennium), a joint venture of SJI and Conectiv Solutions LLC (Conectiv), primarily provides meter reading services to SJI's and Conectiv's regulated utility affiliates. For purposes of this audit, Millennium has been treated as a related competitive business segment of a public utility holding company. Millennium's relationship and interaction with SJG along with an analysis of potential cross-subsidization are discussed in Chapter 5.
- C South Jersey Energy Company (SJE), SJI's retail energy marketer, also provides energy management services and, through a joint venture, markets an air quality monitoring system. SJE has been quite successful in dominating the residential retail gas market in SJG's service territory, serving approximately one-quarter of all customers and over eighty percent of all customers who have chosen to

¹ SJI news release dated January 28, 2003.

² OC-25.

purchase gas from a marketer.³ The relationships and transactions between SJG and SJE are discussed in Chapter 6.

- C South Jersey Resources Group, LLC (SJRG), SJI's wholesale natural gas marketer, was a significant operation for SJI during the audit period. However, it is likely that it would not be subject to the Affiliate Standards which establish rules for entities that have "retail customers". Nevertheless, we documented our observations of SJRG's interactions with SJG during the audit period as part of Chapter 2.

IV. Summary of Audit Findings and Conclusions

The following discussion directly addresses the audit objectives stated in the Request for Proposal. A summary of all audit findings by topic is included at the beginning of each report chapter.

A. Applicability of Affiliate Standards to Non-Regulated Affiliates and Business Units

SJI differentiates between affiliates it believes are and are not subject to the Affiliate Standards. Affiliates that SJI believes are subject to the Affiliate Standards are as follows⁴:

- C South Jersey Gas Company Appliance Service Business (ASB), a competitive service segment of SJG discussed in Chapter 4.
- C South Jersey Energy Company (SJE), a competitive service segment of SJI discussed in Chapter 6.
- C SJ EnerTrade, Inc., a subsidiary of South Jersey Energy Company discussed briefly in Chapter 6.

Key affiliates that SJI does not believe are subject to the Affiliate Standards include:

- C Millennium Account Services LLC (Millennium), a meter-reading service jointly owned by SJI discussed in Chapter 5.
- C South Jersey Resources Group, LLC (SJRG), a wholesale gas marketer discussed in Chapter 2.

The audit considered relationships and transactions between SJG and all non-utility affiliates. Although the audit included analysis of all affiliates with which SJG had a significant relationship or transactions, it was not within the audit's scope to determine whether affiliates should be classified as "competitive service segments" or "retail affiliates." Affiliate Standards identify

³ Interview notes: Michael Renna, December 17, 2002 (No. 32).

⁴ OC-9.

services such as metering and billing as competitive services. The BPU Staff has opined that Millennium is a competitive business segment. The BPU accepted a recommendation to consider reclassifying Millennium as a competitive business segment which was made in the prior audit of Atlantic City Electric Company. For these reasons, we have interpreted the Affiliate Standards as applicable to Millennium. It should be noted that relationships and transactions between SJG and affiliates can affect SJG and its ratepayers regardless of whether the affiliate is deemed to be subject to Affiliate Standards.

B. Adequacy of Accounting Separation Between Utility and Affiliate Revenues, Costs and Assets

1. SJJ maintained separate financial accounting for SJG and its non-utility affiliates except for the ASB. While SJG separated the ASB's operations from the regulated utility's operations for income statement purposes, no separation of assets was made between the two for balance sheet purposes. When the ASB is transferred to a newly created subsidiary of SJJ as proposed by SJG in its petition to the BPU, the separation of assets for accounting purposes between the ASB and the utility should improve (Chapters 2 through 6).⁵
2. SJJ did not maintain effective management accounting separation between SJG functions and those corporate and administrative functions providing benefits to all subsidiaries. Many shared corporate service functions were maintained within SJG, rather than within SJJ (Chapter 3).⁶
3. In general, SJJ did not maintain adequate procedures to ensure the proper allocation of corporate costs among affiliates. SJG was likely charged for costs that it did not cause as a result of SJJ's use of exception time reporting by employees of shared corporate service functions maintained within SJG. SJJ's use of a three-factor formula to allocate certain shared corporate service functions was not consistent with attributable cost principles designed to ensure that costs are distributed on the basis of causation. Many audit period allocations were inadequately supported by workpapers. As a result, we were often unable to determine whether costs benefitting all affiliates and the costs of shared utility functions benefitting both SJG and the ASB were fully and properly allocated. Utility dispatch employees shared by SJG and the ASB was an exception. To the extent employee time was properly input into an automated dispatching system, dispatch labor cost assignments were consistent with attributable cost principles (Chapters 3 and 4).
4. SJG and its affiliates often failed to properly segregate dedicated expenses from fully allocated shared expenses (Chapters 3 through 6).

⁵ Separate financial accounting means separate general ledgers (or sub-ledgers) and financial statements.

⁶ Separate management accounting means separate for utility and affiliate organizational costs at the departmental level.

5. Internal control over transactions between SJG and affiliates was adequate in some respects, but requires significant improvement in several areas. Most inter-company services were documented in inter-company agreements. Generally, transactions between affiliates were summarized in a single monthly invoice, and inter-company payable and receivable accounts were periodically settled. However, SJI lacks basic management accounting procedures (namely, maintaining costs by department or function) to enable calculation of the fully allocated cost of performing shared corporate and utility functions. The inconsistent use of inter-company payables and receivables accounts to record affiliate transactions, the use of intermediate affiliates in billing costs from one affiliate to another, and a general lack of affiliate transaction documentation made it very difficult to analyze the nature and amounts of products and services provided between SJG and affiliates. These are significant control weaknesses (Chapter 2).

C. Adequacy of Functional and Management Separation Between SJG and Affiliates

1. SJG Utility and the Appliance Service Business (ASB) - SJI made progress during the audit period in separating the ASB from the utility. The ASB opened its own dedicated dispatch and call center and segregated its non-emergency repair parts from SJG in 2002. Management separation between the ASB and SJG was adequate. However, the functional separation of SJG and the ASB was not complete. ASB and certain SJG employees perform appliance repair and utility work interchangeably, and the ASB and SJG call center employees have access to each other's customer data (Chapter 4).
2. SJG Utility and Millennium - Millennium, a joint venture owned by SJI and Conectiv Solutions LLC (Conectiv) performs meter reading for SJG and a Conectiv subsidiary, Conectiv Power Delivery.⁷ The management of SJG and Millennium are not adequately separated because members of SJG's executive management are also on Millennium's Executive Committee. Although Millennium has its own operating facilities and a dedicated meter reading work force, Millennium employees have access to SJG's customer information; thus, SJG and Millennium are also not completely separate from a functional standpoint (Chapter 5).
3. SJG Utility and SJE - SJE is SJI's deregulated energy supplier for residential, commercial, and industrial customers. While SJE maintained a separate employee organization, segregated its office space from SJG, and restricted access to SJG information systems, management and functional separation between SJG and SJE remains inadequate for several reasons. SJE management participates in meetings that involve SJG. SJG's recently-selected President was formerly SJE's President. SJE uses SJG's utility employees to encourage customers to switch from the utility to SJE for purposes of purchasing gas commodity (Chapter 6).
4. SJG Utility and SJRG - SJRG is SJI's wholesale gas marketer. SJRG's primary operations are located in Texas. Management represents that SJRG has little or no

⁷ Formerly known as Atlantic City Electric Company.

access to SJG's information systems. For these reasons, the functional separation between SJG and SJRG appears adequate. However, SJG and SJRG share a common corporate officer. When the two entities transact business with each other, this creates the potential for a conflict of interest (Chapter 2).

5. SJG Utility and Other Entities - Several SJG affiliates were generally inactive during the audit period, including Energy & Minerals, Inc., South Jersey Fuel, Inc., and R&T Group, Inc. In addition, SJL's interest in Measurement Solutions International - Northeast LLC was immaterial (4%). Marina Energy, LLC was in a project-development phase during the audit period and had no employees. Functional and management separation is not an issue with these affiliates (Chapter 2).

D. Cross-Subsidization

1. Common Cost Allocations - It appears likely that certain corporate and shared utility costs were over-allocated to SJG. Actions taken by SJL and SJG that likely directed excess costs to SJG include the use of exception time reporting by employees of shared corporate service functions maintained within SJG (i.e., the tendency for time to default to SJG if not properly recorded elsewhere on an exception basis), misalignment of shared corporate service functions within SJG that drew costs to SJG as a result of employee or payroll factors, and SJL's use of a three-factor formula to allocate certain corporate costs. To the extent they occurred, many of these cross-subsidies cannot be quantified without an improved audit trail and an attributable cost allocation study of SJL's corporate functions (Chapter 3).
2. The ASB - To the extent that SJG recorded certain costs that should have been charged or allocated to the ASB, the mis-charged or mis-allocated costs were cross-subsidized by SJG. For the reasons described above, we cannot quantify any SJG-to-ASB cross-subsidy. It appears possible that the ASB's share of some common costs were under-allocated; however, to the extent this occurred, we do not believe these under-allocations were large enough to have eliminated the ASB's operating profit. Thus, it appears unlikely that ASB's *prices* reflected cross-subsidies and it is therefore unlikely that cross-subsidies affected the competitive market for appliance services in SJG's service territory (Chapter 4).
3. Millennium - Affiliate Standards limit the price Millennium is permitted to charge SJG to the lower of fully allocated cost or market. Millennium's prices exceeded both fully allocated cost as well as "market-comparable" prices evidenced in bids submitted by two other companies. Analysis indicates that fully-allocated cost was the maximum price Millennium was permitted to charge SJG under Affiliate Standards. Based on the amounts by which Millennium's prices exceeded fully-allocated costs, we estimate SJG cross-subsidized Millennium by approximately \$443,000 in 2001 and by approximately \$587,000 in 2002 (Chapter 5).
4. Transfer of ASB Going Concern Value - SJG's BPU petition to transfer the ASB to a subsidiary will result in the transfer of appliance service customer contracts and associated cash flow. The discounted value of this cash flow represents the going concern (economic) value of the appliance service business, something that SJG would

not give to a non-affiliate without obtaining compensation. Nothing in the Affiliate Standards requires compensation for the transfer of business value. Therefore, although a transfer of economic value will occur with the transfer of the business, it does not appear to meet the definition of a cross-subsidy under existing Affiliate Standards (Chapter 4).

5. Brand Value - Both the ASB and SJE obtain value from their affiliation with SJG and their shared use of the SJI brand, which also derives primary value from SJG. Neither the ASB nor SJE pay for their use of the brand, and nothing in Affiliate Standards requires such compensation. Under these circumstances, uncompensated brand value does not appear to represent a cross-subsidy (Chapters 4 and 6).

E. Ratepayer Impact of Using Utility Assets to Provide Competitive Services

The ASB leases vehicles from SJG to provide appliance services. Millennium leases some minor amounts of office and computer equipment from SJG. We do not consider these items to have a significant impact on SJG or its ratepayers.

F. The Impact of Competitive Services on Utility Workers

It does not appear that SJG's competitive services significantly affected utility workers during the audit period. SJE's entry into the retail gas commodity market should not affect the force level or compensation level of SJG employees. Millennium resulted in the transfer of union-represented employees from SJG. By the end of the audit period, all employees that wished to return to SJG had done so. SJG's separation of appliance services into a separate affiliate does not appear likely to significantly affect employee force levels or compensation.

G. The Impact of Utility Practices on the Market for Competitive Services

The ASB has several significant advantages over smaller competitors. These include affiliation with the utility and its recognized name, economies of scale, access to the utility's billing envelope, use of utility customer information and inclusion on the utility's automatic call router. Of the three utility-appliance relationships we audited, only SJG permitted its appliance service business to use utility customer data for marketing purposes. The ASB faces some minor competitive disadvantages. They include negative impressions some people have of the utility, being restricted to tariffed rates and the incurrence of certain corporate overhead costs not incurred by smaller competitors. On balance, we believe the competitive advantages outweigh the disadvantages with respect to smaller competitors. The ASB may not have an advantage over larger retailers, which may have nationally recognized brands and similar economies of scale.

By fiscal year 2002, SJE had captured more than 80 percent of the residential customers who left the utility for competitive suppliers. This appears to be due in part to SJE's marketing approach, which combines a retail store gift card with a discount guaranteed for a full heating season. However, SJE's ability to capture more than four out of five customers leaving the utility is also the result of a significant competitive advantage: its affiliation with SJG's brand and reputation as a reliable local supplier. In addition, as noted above, SJE actually uses utility

employees to encourage SJG customers to leave the utility. This practice makes sense from SJI's perspective because SJE is permitted to earn a profit on gas it sells, while SJG is not.

From the perspective of the marketplace as a whole, *all* non-utility marketers, including SJE, have an implicit cost advantage over SJG, which alone must bear certain capacity and storage costs associated with its responsibility as supplier of last resort. SJG's cost disadvantage ([redacted]) provides a large enough cushion to enable SJE, and possibly other non-utility suppliers, to use the same interstate pipelines and sources of supply as SJG while, at the same time, providing a discount from SJG's cost of gas and earning a profit. Because SJG is permitted to fully recover its supplier-of-last-resort costs over whatever customer base remains with the utility, the addition of marketing costs and margins for non-utility suppliers theoretically increases the total cost to supply gas to the market unless competition induces SJG to lower its own supply costs. If SJG felt any competitive pressure (and without a profit incentive on the gas commodity, it should not), its employees would probably not be provided incentives to encourage customers to switch to SJE. The current set of market dynamics could provide a disincentive for SJG to minimize its own supply cost because, by doing so, SJG reduces the potential margin available for SJI (through SJE) to profit from the sale of gas in SJG's service territory.

H. Implementation of Prior Audit Recommendations

In general, SJI complied with the prior audit recommendations adopted by the BPU. To the extent the BPU's Affiliate Standards apply only to the affiliates that SJI believes are competitive business segments (the ASB, SJE, and SJ EnerTrade, Inc.), SJI now complies with prior audit recommendations concerning shared board memberships, shared corporate officers and related procedures. If the Affiliate Standards also apply to Millennium or SJRG, some of SJI's board and officer memberships are currently at variance with the Affiliate Standards, and as a result, SJI has unsuccessfully implemented two prior audit recommendations. In addition, SJG only partially complied with the recommendation concerning the timely performance of a cost allocations audit (internal audit department review does not appear to be a detailed audit). We were unable to reach a conclusion on the implementation of another recommendation. In performing our audit, we also considered prior audit recommendations that were deferred or rejected by the BPU. To the extent we believed these recommendations had validity, they have been considered in our current audit recommendations, discussed below.

V. Audit Recommendations

A. Affiliate Transactions Documentation and Internal Control

1. Create separate inter-company payable and receivable accounts for each SJI subsidiary and joint venture and record all inter-company transactions in these accounts [Finding 2-II-A].

During the audit, the company's Accounting Department had a difficult time identifying all inter-company transactions between affiliates. This was likely due to their treatment of some transactions as unaffiliated in nature. Transactions that are not required to be eliminated can be

segregated in a second “inter-company” account if need be. Transactions between two affiliates should not be “passed through” a third affiliate.

2. Develop a single monthly inter-company invoice summarizing all charges from one affiliate to another [Finding 2-II-A].

As an example, SJL issues multiple inter-company invoices to SJG on a monthly basis. Such a system unnecessarily adds to the complexity of reviewing the inter-company charges and increases the possibility of mis-recorded transactions between any two affiliates.

If the ASB continues to remain within the SJG organization, it should be treated as a separate affiliate for purposes of implementing this recommendation. In the case of transactions between SJG and the ASB, intra-company invoices or other similar documentation should be prepared.

3. Since the same person currently holds both positions, delineate the job responsibilities of the Assistant Vice President - Gas Supply & Off-System Sales of SJG and Vice President of SJRG in writing. Document how potential conflicts of interest in these positions will be avoided when the two companies transact business with each other [Finding 2-II-B].

SJRG sold over \$43 million of natural gas to SJG during the audit period. SJG, in turn, sold approximately \$34 million to SJRG during the same time period. To avoid any conflicts of interest (in practice or appearance) that may occur as a result of one person having involvement on both sides of the same transaction, job responsibilities for these positions should be documented in writing. In addition, these job responsibilities should reference the specific internal control procedures that SJG and SJRG have adopted to prevent any conflicts of interests from occurring.

4. Adjust the officer appointments and/or board memberships of SJG, Millennium, and other subsidiaries to comply with Affiliate Standards or obtain permission for variances from the BPU [Finding 2-II-C and 5-II-C].

Albert Ruggiero, SJG Executive Vice President and Chief Administrative Officer, and Richard Walker, SJG Corporate Secretary and Corporate Counsel, serve on the Executive Committee of Millennium. BPU staff have opined that the meter reading functions offered by Millennium constitute a “competitive service” that is subject to the Affiliate Standards. Given this, SJG is not in compliance with the Affiliate Standards that prohibit common officer / board participation of utilities and related competitive business segments. SJG should either adjust Mr. Ruggiero’s and Mr. Walker’s appointments to SJG or Millennium officer positions and/or “boards” (e.g., Executive Committee) or obtain a letter from the BPU sanctioning the variance. The BPU should clarify whether Affiliate Standards’ board and officer restrictions apply to memberships and positions only with “retail affiliates” or to all non-utility affiliates, regardless of the wholesale or retail status of the services they provide. If similar restrictions are applicable to wholesale gas marketing businesses, the common officer titles held by Jeffrey DuBois would also need to be addressed.

5. Resubmit the SJG Compliance Plan after incorporating the findings and conclusions of this report and file on an annual basis thereafter. Summarize the changes in the Compliance Plan at the beginning of the document for ease of comparison.

A similar, more general recommendation was made by the prior auditor, and an updated plan was not filed by SJG until February of 2003. To more easily identify the changes that have been incorporated in the Compliance Plan from year to year, SJG should make note of all changes in a summary at the front with appropriate cross-references to the following detailed plan.

B. Cost Allocations

1. Adopt an attributable cost basis for allocating the common costs of SJI departments and SJG departments providing shared services. Retain supporting workpapers for these allocations [Findings 2-II-A, 3-II-A, 3-II-B, 3-II-C, 3-II-D, 3-II-E].

SJI and SJG currently allocate most of their costs on a transaction-by-transaction basis. This piecemeal approach increases the chance that some costs will not be properly identified and allocated.

A significant amount of residual corporate costs are allocated on the basis of a three-factor formula (assets, payroll, and gross margin). The three-factor formula does not link common costs to subsidiaries based on causation. The factors SJI has selected for the formula result in a significant over-weighting of cost allocations to SJG, the regulated utility.

SJI and SJG should stop allocating on a transaction-by-transaction basis and should stop using the three-factor formula as a basis for cost allocations and replace both with an attributable cost allocation procedure.⁸ Allocation procedures should be enhanced as follows:

- C Departments or costs centers should be developed to account for the different shared corporate service functions (e.g., accounting, human resources, etc.).
- C As is generally being done now, employees should track their time spent on each affiliate and/or related competitive business segment based on which gave rise to the cost. (Exception time reporting should not be permitted as long as shared corporate services are housed within SJG to prevent incorrect labor cost defaults to the utility.) Each department should track the labor cost associated with the work performed for each affiliate.
- C Likewise, costs incurred by each department should be tracked and allocated to each affiliate and/or related competitive business segment based on cost causation. To the extent that SJI has identified specific costs in its Cost Allocation Manual (CAM), many of these costs appear to be assigned on this basis.

⁸ Attributable cost principles are discussed in Chapter 3.

- C Once all costs that can be directly assigned or allocated on the basis of cost causation are identified, some departments may have “residual” unallocated costs. Some departments are more likely than others to have unallocated costs. Examples include executive, legal, and external relations. Under attributable cost procedures, these “residual” costs should be allocated in proportion to the relative levels of costs directly assigned and allocated on an attributable basis.

Spreadsheets, workpapers, and other support for these allocations should be maintained and kept for future review both in hard copy format and electronically, to the extent possible.

2. Make necessary adjustments to all cost allocations affected by the organizational misalignment of shared corporate services [Finding 3-II-B].

Organizationally, shared corporate services more appropriately belong either in the parent or a service company. SJG has instead chosen to place many of these shared corporate services in SJG, the regulated utility. If not properly monitored, such a misalignment could lead to the misallocation of costs to affiliates oftentimes to the detriment of SJG.

Given the BPU’s reluctance to accept the prior auditor’s recommendation to establish a service company, we assume that any similar recommendation for reorganization would likewise meet resistance. In the alternative, SJG has to demonstrate through its cost allocation procedures that the shared corporate services’ unallocated costs are allocated to affiliates in proportion to the costs directly assigned or allocated on an attributable cost basis rather than defaulting to SJG as is currently the case.

C. South Jersey Gas Company Appliance Service Business

1. Track assets and costs as specifically identified in the Affiliate Standards for all affiliates and related competitive business segments [4-II-A].

We noted that the ASB did not track its assets nor could it distinguish its dedicated expenses from its fully allocated shared expenses. Accounting management indicated that no distinction is made on the general ledger between costs incurred directly and those billed by an affiliate.⁹

2. Prohibit appliance service technicians from performing utility work and prohibit utility technicians from performing appliance repair service except in cases of emergency [4-II-D].

Not only does the ASB gain a competitive advantage by having a supplemental workforce available in times of heavy business but any distinction the public makes between the ASB and the utility is impaired when utility workers perform ASB work. In “make safe” situations, it is important that appliance service technicians have the ability to assist the utility, but in all other cases, such actions should be prohibited.

⁹ Interview notes : Thomas Kavanaugh, October 10, 2002 (No. 31).

SJG believes that the advantages derived from having a contingent workforce available to each business outweigh any concerns that may exist as it relates to compliance with the Affiliate Standards.¹⁰ SJG has not provided a quantification of the benefits derived from continuing to allow its workforce to do both utility and ASB work nor has it provided any objective support for its assertion. If SJG provides credible evidence of the benefits derived from its continued use of a contingent workforce and the BPU determines that these benefits outweigh the goals and objectives of the Affiliate Standards, the BPU should grant SJG a waiver to its Affiliate Standards.

3. Prohibit the ASB from using the utility's database from future targeted marketing [Finding 4-II-F].

The Affiliate Standards do not permit the ASB to mine the utility's customer database to market its business when competitors are not afforded the same opportunity.¹¹ At a minimum, the ASB should be prohibited from carrying on this action in the future. In addition, the BPU should consider what steps can be taken to put competitors on an equal footing given past actions of the ASB.

D. Millennium Account Services LLC

1. Modify the agreement between Millennium and SJG to price meter reading services to recover no more than Millennium's fully allocated costs, including a regulated return on SJI's investment [Finding 5-II-F].

In 2001 and 2002, SJG effectively cross-subsidized its parent approximately \$1 million through its dealings with Millennium.

In the future, the prices charged by Millennium to SJG should be subject to review by the BPU. The prices should be calculated in such a manner to recover Millennium's fully allocated costs, including all administrative services provided by its partners, and a regulated return on investment.¹² Costs billed by SJG or SJI for administrative services should be based on attributable cost principles and should not result in double recovery of costs -- once from the utility and once from Millennium. Prices "negotiated" between SJG and Millennium should not be based on a reasonableness standard that cannot be objectively analyzed.

¹⁰ Based on SJG response to draft report and discussions at exit interview on February 24, 2003.

¹¹ Affiliate Standards 14:4-5.3(m) and 14:4-5.6(m).

¹² To permit a higher return would encourage SJG to move other internal functions to unregulated entities.

2. Delete provisions in the Meter Reading Services Agreement dated December 1, 2001 between SJG and Millennium which permit Millennium to compel SJG to take ownership of certain meter reading equipment [Finding 5-II-G].

Millennium has earned a return in the past on its business with its two primary affiliated customers that exceeds SJG's allowed rate of return and expects to continue to do so in the future.

Millennium is a relatively low-risk venture. Its two primary customers are affiliates; it has long-term contracts with both of these customers (the SJG contract terminates at the end of 2006); and the earnings reported by Millennium are sufficient to pay off its investment in new meter reading equipment in less than a year.

Millennium and SJG agreed to a provision in the latest meter reading services agreement whereby Millennium can "put" certain meter reading equipment to SJG at a cost of \$4,760 per month through December 31, 2006 if the BPU requires Millennium and SJG to terminate the contract at an earlier date (Section 18.1). Such a provision effectively transfers the risk of ownership of the new meter reading equipment to SJG without any of the associated benefits, such as favorable pricing.

Without making substantive changes to other sections in the contract, this provision and references in Section 18.2 to this provision should be removed.

E. South Jersey Energy Company

1. Prohibit any direct or indirect compensation of SJG employees for marketing, selling, or promoting SJE products and services [Finding 6-II-A and 6-II-C].

SJE paid SJG employees over \$120,000 to promote its services during the audit period. It is likely that most of the customers involved in these promotions were formerly SJG firm sales service customers. Affiliate Standards prohibit utilities from assisting related competitive business segments in marketing unless such services are offered to all competitors on a non-discriminatory basis.

If not expressly prohibited, it is highly unlikely the SJG employees were actively promoting the products and services of SJE's competitors. This, by definition, would create an environment in which SJE's products and services were marketed on a discriminatory basis. In addition, SJG employees selling SJE products and services reinforces the notion that these are not separate companies "competing" against each other.

At a minimum, any compensation to SJG employees for promoting SJE's services should be prohibited. This should include any incentive compensation awards made by SJI or SJG to SJG employees which are tied to any promotional efforts of these employees which benefit SJE.

Chapter 2 - Organization Overview, Internal Control, Board and Officer Restrictions and Implementation of Prior Audit Recommendations

Chapter 2 - Organizational Overview, Internal Control, Board and Officer Restrictions and Implementation of Prior Audit Recommendations

I. Introduction

This chapter provides an overview of South Jersey Industries, Inc. (SJI) and its subsidiaries, a brief summary of South Jersey Gas (SJG) Company's relationship and transactions with South Jersey Resources Group, LLC, an assessment of SJI internal controls governing affiliate transactions, an assessment of SJI's compliance with Affiliate Standards concerning shared corporate officers and board members, a review of SJG's implementation of prior audit recommendations and our audit analysis of cross-subsidization.

II. Summary of Audit Findings

A. Affiliate Transaction Internal Control

We examined the internal controls in place to ensure that SJI's and SJG's inter-company transactions are properly identified, measured and charged to the appropriate SJI subsidiaries. Most inter-company services are formally documented in agreements. We found control weaknesses in the procedures used to allocate the common costs of shared corporate and utility functions due to shortcomings of SJI's Cost Allocation Manual. SJI procedures for controlling affiliate transactions through inter-company payables and receivables accounts were inconsistent. Some affiliate transactions were charged to these inter-company accounts while others were not. This may explain difficulties SJG experienced in trying to identify and account for all transactions with affiliates. To the extent inter-company payables and receivables were used, the balances were settled on a periodic basis. Support for inter-company payable and receivable activity between two entities usually consisted of an inter-company invoice. This assisted in understanding the nature and amounts of affiliate transactions. However, there were instances in which transactions such as accruals were omitted from inter-company invoices, multiple inter-company invoices between the same two affiliates were sometimes issued, intermediary affiliates were used to pass costs from one affiliate to another, and SJG lacked formal documentation of charges between the ASB and other affiliates.

B. South Jersey Resources Group, LLC (SJRG)

SJRG is in the wholesale gas marketing business. As such, it likely is not subject to the Affiliate Standards. Nevertheless, SJRG has taken steps to separate its business from SJG. SJRG maintains a separate general ledger and is serviced by the SJI accounting group. Except for officers, SJRG's employees are located in Texas. Management represents that SJRG has little or no access to SJG's information systems. However, both SJG and SJRG have a common corporate officer who appears to have a conflict of interest when transactions transpire between the two companies. We found no evidence to suggest that SJG and SJRG jointly market products or services.

C. Compliance with Affiliate Standards Board and Corporate Officer Restrictions

In general, SJG complies with Affiliate Standards restrictions governing board memberships and corporate officer appointments. Two exceptions include SJG's Executive Vice President and Chief Administrative Officer, Albert Ruggiero, and SJG's Corporate Secretary and Corporate Counsel, Richard Walker, both of whom also serve on the Executive Committee of Millennium Account Services LLC (Millennium). We believe that Millennium qualifies as a related competitive business segment under the Affiliate Standards. If so, such dual roles are prohibited by the Affiliate Standards. In addition, if "competitive services" included the wholesale gas marketing business, SJG's Assistant Vice President of Gas Supply and Off-System Sales, Jeffrey DuBois, would not be in compliance with the Affiliate Standards since he also serves as Vice President of SJRG.

D. Prior Audit Recommendations

We examined the implementation of all audit recommendations made during the prior audit. In general, SJI complied with the prior audit recommendations adopted by the BPU. Of the thirteen audit recommendations accepted by the BPU, SJG implemented nine, partially implemented one, and based on the BPU Staff's interpretation that affiliate Millennium (the meter-reading affiliate) is a competitive services segment subject to the Affiliate Standards, did not successfully implement another two. The two recommendations that were not implemented relate to board memberships and officer responsibilities shared between SJG and Millennium. Should the BPU determine that Millennium is *not* a competitive services segment subject to the Affiliate Standards, the status of these recommendations would change from "not implemented" to "successfully implemented." As of the writing of this report, we could not reach a conclusion on the implementation status of the thirteenth recommendation.

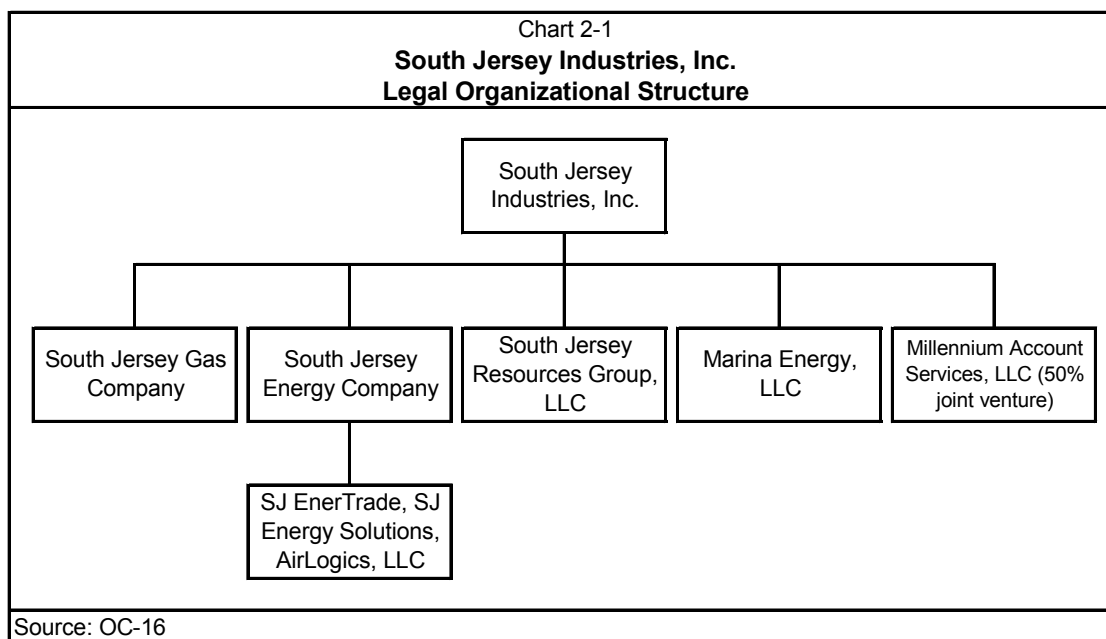
III. Overview of SJI's Corporate Structure

South Jersey Industries, Inc. (SJI or the Company) is an energy services holding company headquartered in Folsom, New Jersey. The Company's subsidiaries provide a variety of regulated and unregulated energy related products and services. The primary entities residing under the SJI umbrella include:

- C South Jersey Gas Company (SJG)
- C South Jersey Energy Company (SJE)
- C South Jersey Resources Group, LLC (SJRG)
- C Marina Energy, LLC (Marina)
- C Millennium Account Services LLC (Millennium)

A. Organizational Flowchart

The following chart provides a graphical view of the Company's corporate structure. Following the chart, brief descriptions of each of the subsidiaries listed above as well as descriptions of several of the Company's other subsidiaries and ventures are provided.



B. **SJI Subsidiary Descriptions**

1. **South Jersey Gas Company (SJG)**

SJG is a regulated gas utility providing natural gas to residential, commercial and industrial customers in southern New Jersey. SJG also executes off-system sales of gas to customers on the interstate pipeline system, transports gas bought from producers and suppliers for its own sales or use by its customers and provides appliance repair services through a warranty program, a flat rate program, and on a time-and-materials basis.¹

2. **South Jersey Energy Company (SJE)**

SJE is an unregulated subsidiary that offers natural gas and electricity marketing to retail customers and energy management services to commercial and industrial customers, mainly in the SJG service area. SJE's lone subsidiary, SJ EnerTrade, sells gas to casinos in the Atlantic City, New Jersey area.² The Company plans to eventually fold SJ EnerTrade into SJE.³

SJE also has interests in two equally-owned ventures, South Jersey Energy Solutions, LLC (Energy Solutions) and AirLogics, LLC (AirLogics). Energy Solutions, jointly owned by Energy

¹ December 31, 2001 SJI Form 10-K.

² December 31, 2001 SJI Form 10-K and Interview Notes: Executive Management presentation, October 31, 2002.

³ Interview Notes: Executive Management presentation, October 31, 2002.

East Solutions, Inc., markets retail electricity.⁴ AirLogics, jointly owned by GZA GeoEnvironmental, Inc., sells real-time air quality monitoring systems.⁵

3. South Jersey Resources Group, LLC (SJRG)

During the audit period, SJRG became a wholly-owned subsidiary of SJI after the Company purchased the remaining fifty percent interest in the entity from UPR Energy Marketing. SJRG offers wholesale natural gas storage, commodity and transportation.⁶

4. Marina Energy, LLC (Marina)

Marina is a subsidiary created to develop and operate energy-related projects in southern New Jersey. Marina is currently developing a project for the Borgata Resort, an Atlantic City casino, to provide the casino's heating, cooling and hot water needs.⁷

5. Millennium Account Services LLC (Millennium)

Millennium is a joint venture between SJI and Conectiv Solutions, Inc (Conectiv). Millennium furnishes meter reading services to both SJG and Conectiv Power Delivery, an affiliate of Conectiv. Both parties own fifty percent stakes in Millennium.⁸

6. Other Subsidiaries and Ventures

Other subsidiaries and ventures of SJI disclosed during the audit include Measurement Solutions International - Northeast, LLC (MSI), Energy & Minerals, Inc. (EMI), South Jersey Fuel, Inc. and R&T Group, Inc.

SJI owns a four percent interest in MSI; the other ninety-six percent is owned by Measurement Solutions International. MSI offers metering and measurement services to utilities and energy service providers in the northeast United States. It currently has one customer other than SJG.⁹

⁴ December 31, 2001 SUI form 10-K and Interview Notes: Executive Management presentation, October 31, 2002.

⁵ Ibid.

⁶ December 31, 2001 SJI Form 10-K.

⁷ December 31, 2001 SJI Form 10-K and Interview Notes: Executive Management presentation, October 31, 2002.

⁸ 2001 SJI Annual Report to Shareholders.

⁹ SJI news release dated July 11, 2000 and interview notes: Executive Management presentation, October 31, 2002 (No. 9).

EMI is an inactive entity that principally manages the liabilities related to non-utility affiliates whose operations have been discontinued.¹⁰ South Jersey Fuel, Inc. is an inactive affiliate that previously operated a fuel oil business.¹¹ R&T Group, Inc. was the Company's construction subsidiary. The affiliate sold its operating assets in 1997.¹²

C. SJI Subsidiary Testing

1. Inactive or Insignificant Operations

For purposes of auditing the competitive business segments of SJG, we concluded it would not be necessary to perform substantial analysis of the inactive subsidiaries and joint ventures of SJI. These include EMI, South Jersey Fuel, Inc. and R&T Group, Inc. A review of the consolidating income statement of SJI for the twelve months ended December 31, 2001 and nine months ended September 30, 2002 confirmed that none of these three entities generated any significant operating revenues, expenses or income.¹³

While SJI's investment in MSI technically would qualify as a related competitive business segment of a public utility holding company based on our interpretation of the Affiliate Standards¹⁴, SJI's investment in the joint venture is minimal both on an absolute basis (\$40,000) and a relative basis (4%).¹⁵ As a result, we decided to focus our efforts elsewhere. SJG management does not believe that MSI is a related competitive business segment.

During the audit period, Marina was constructing the Marina Thermal Facility (scheduled to become fully operational in 2003) which will provide for the needs of the Borgata Resort. Although it had some other projects underway, Marina's operations were negligible during 2001 and the first nine months of 2002 (less than \$100,000 in cumulative net income).¹⁶ Given the development-stage nature of this entity, we performed limited testing of this entity.

¹⁰ 2001 SJI Annual Report to Shareholders.

¹¹ Ibid.

¹² Ibid.

¹³ OC-79.

¹⁴ Affiliate Standard 14:4-5.2 - "related competitive business segment of a public utility holding company" means any business venture of a public utility holding company, including, but not limited to, functionally separate business units, joint ventures and partnerships and subsidiaries, that offers to provide or provides competitive services, but does not include any related competitive business segments of an electric public utility or gas public utility.

¹⁵ Interview notes: Executive Management presentation, October 31, 2002 (No. 9).

¹⁶ OC-79.

2. SJRG

SJRG markets wholesale natural gas storage, gas commodity and gas transportation in the mid-Atlantic and southern United States, presumably including the state of New Jersey. While it is probable that SJRG's wholesale business is not subject to the Affiliate Standards, we have documented the following observations:

a. Separation from SJG

- C Accounting - SJRG maintained separate accounting records from SJG and had its own gas accountant.¹⁷ Financial reporting and general accounting for SJRG was primarily the responsibility of the small accounting staff housed within the parent, SJI.¹⁸
- C Offices and Employees - The operational employees of SJRG were located in Texas and reported to Jeffrey DuBois, Vice President, and Edward Graham, President, both of whom were located in Folsom, New Jersey.¹⁹ Mr. DuBois also served as SJG's Assistant Vice President of Gas Supply and Off-System Sales for a significant portion of the audit period. During the audit period, Mr. Graham was not an officer of SJG as he had relinquished his officer responsibilities with SJG in 2000. However, he recently was appointed President of SJG effective January 1, 2003.²⁰
- C Assets and Information Systems - Although insignificant (less than 0.1% of total assets as of December 31, 2001 and September 30, 2002²¹), most physical assets owned by SJRG were located in Texas. Management represented to us that SJRG had little to no access to shared information systems with SJG.²²

Other than the dual officer roles Mr. DuBois held with SJG and SJRG, it appears that the two entities have taken adequate precautions to separate these businesses. When we requested Mr. DuBois' job descriptions for both SJG and SJRG, SJG said that neither existed.²³ Since these two entities transact business with one another, the appearance of a conflict of interest exists. We believe that, at a bare minimum, Mr. DuBois' responsibilities to each company should be formally documented.

¹⁷ OC-40 and OC-25.

¹⁸ Interview notes: David Robbins, November 21, 2002 (No. 11).

¹⁹ OC-25 and OC-13.

²⁰ Review of SJG Board of Directors' minutes. SJI news release dated November 26, 2002.

²¹ OC-79.

²² Interview notes: Patrick Finnigan, October 30, 2002 (No. 7) and OC-113.

²³ OC-64.

b. Marketing and Advertising - SJRG operates in wholesale markets that do not likely provide opportunities for cross-marketing and promotion with SJG. SJRG's marketing relies primarily on market knowledge and customer relationships. While we did not find any obvious opportunities for joint marketing and promotion between SJG and SJRG, corporate business plans that may have shed light on the subject were either dated (SJI) or never provided (SJRG).²⁴ In addition, SJG's small size makes it unlikely that SJRG's association with SJG provides name recognition value to SJRG.

c. Inter-company Services, Transfer Pricing and Cost Allocations

C Products and Services Provided by SJRG to SJG - SJRG provides inter-company services to SJG, most prominently acting as a source of market intelligence for SJG and providing the financial risk management function as it relates to natural gas commodity. In some cases, these services were provided at no cost to SJG and at other times they were added as a mark-up to the financial transaction completed.²⁵ Due to time constraints, we did not have an opportunity to investigate these services in detail. However, the Affiliate Standards do not appear to prohibit competitive business segments from *under-charging* the utility.

Additionally, SJRG occasionally sold gas commodity to SJG.²⁶ During 2001 and the vast majority of 2002 (January 1, 2002 - December 19, 2002), the gas sold by SJRG to SJG totaled \$30,150,419 and \$12,858,475, respectively.²⁷ We did not audit the reasonableness or prudence of these purchases since they would be reviewed as part of the utility's LGAC filing and audit.

C Products and Services Provided by SJG to SJRG - SJRG relies upon SJG to provide general administrative functions such as human resources, information services, legal, etc. However, SJG does not charge SJRG directly, but rather uses SJI as an intermediary. During the twelve months ended December 31, 2001 and the nine months ended September 30, 2002, the labor and benefit costs of the shared services identified by SJG to be specifically related to SJRG totaled \$41,868 and \$48,835, respectively.²⁸ To the extent that shared support services were allocated on the basis of the asset-based factor or three-factor formula (to be discussed in further detail in Chapter 3), SJRG did not receive its

²⁴ OC-32, OC-63, OC-86, and OC-123.

²⁵ Interview notes: Jeffrey DuBois, December 18, 2002 (No. 27) and Edward Graham, December 18, 2002 (No. 33).

²⁶ Interview notes: Jeffrey DuBois, December 18, 2002 (Nos. 14, 17, 21, and 27) and Edward Graham, December 18, 2002 (Nos. 32, 33, and 39).

²⁷ OC-11.

²⁸ OC-11.

fair share of costs. In 2001, SJRG was allocated none of these costs and in the first nine months of 2002, it was allocated 2.3% of the applicable costs.²⁹ This was the case even though executive management had focused corporate effort on managing the risk associated with SJRG's business.³⁰

SJG also sold gas to SJRG during the audit period. Assuming that SJG was required to eliminate these sales for purposes of preparing the SJI consolidated income statement, during the twelve months ended December 31, 2001 and the nine months ended September 30, 2002, these sales totaled \$23,011,257 and \$10,637,172.³¹ SJG represented that it offered no discounts associated with these gas sales.³² SJG asserted that several controls were in place to prevent SJG from selling natural gas to SJRG at below-market prices. These included tying SJG gas traders' compensation solely to SJG's profitability and making comparisons of deal prices with listed market data.³³ If these controls were in place during the audit period, they should have helped assure that SJG did not discriminate in favor of SJRG. However, time constraints prevented us from testing these controls.

3. The Appliance Service Business (ASB), Millennium and SJE

Our testing and the associated findings related to the ASB, Millennium and SJE will be discussed in Chapters 4, 5 and 6, respectively.

IV. Audit Analysis

A. Affiliate Transaction Internal Accounting Control

The ability to audit affiliate transactions and demonstrate that subsidiaries are not cross-subsidized requires that inter-company transactions are recognized, measured and properly recorded. Proper recognition and accurate recording of inter-company transactions depends on a functioning system of internal accounting controls. We made the following observations about internal controls:

1. Inter-company Control Accounts - The use of inter-company receivables and payables accounts to maintain accounting for affiliate transactions is an important accounting control. SJI did not consistently employ inter-company receivable and payable accounts to record affiliate activity. Management acknowledged that SJG did not capture

²⁹ See Table 3-4.

³⁰ Based on a review of the Board of Directors' minutes.

³¹ OC-79.

³² Interview notes: David Kindlick, October 9, 2002 (No. 2) and OC-17.

³³ Interview notes: Jeffrey DuBois, December 18, 2002 (No. 19) and Edward Graham, December 18, 2002 (No. 34).

transactions with SJE, SJRG, Millennium or MSI in inter-company accounts.³⁴ This may explain why it took SJG over five months to provide copies of what SJG asserts to be all audit period affiliate invoices.³⁵ To this date, we are unable to determine if all affiliate invoices have been provided by SJG because SJG management did not provide all pertinent details in its formal response regarding inter-company eliminations.³⁶

2. Timesheets and the Automated Dispatching System (ADS) - A significant portion of the inter-company activity between utilities and their affiliates involves the provision of services by employees to an affiliate other than the company for which they work. Timesheets are a key element in helping to ensure that employee efforts attributable to specific subsidiaries are properly identified and recorded for cost assignment. We found that nearly all SJG and SJI administrative employees use timesheets to separate efforts associated with their "home" subsidiary from time attributable to other subsidiaries. However, to the extent the exception time reporting was employed by any of these administrative departments, time may default to an inappropriate company due to the misalignment of shared corporate functions within the utility (see Chapter 3 for further discussion).

The time of most utility line employees was handled by the ADS. The affiliate most likely to be affected by allocations of time assigned by the ADS was the ASB. We did not test the accuracy of this system.

3. Inter-company Invoices - Inter-company charges between affiliates were generally itemized on a monthly basis in a single bill between the parties. However, there were many exceptions to this rule. Certain charges that were only paid once a year but accrued on a monthly basis were not included on the inter-company invoices.³⁷ Rather than submitting one inter-company invoice for all inter-company charges between SJI and SJG, some SJI departments chose to issue their own individual inter-company invoices.³⁸ As mentioned previously, some inter-company charges were passed through

³⁴ Interview notes: David Robbins, November 21, 2002 (No. 1) and Thomas Kavanaugh, October 10, 2002 (No. 36).

³⁵ OC-11 (originally submitted on July 30, 2002; supplemental response provided on January 15, 2003).

³⁶ "As the population of eliminations does not represent the full population for the reasons stated . . . and due to the complex nature of the elimination [sic], we can not [sic] provide explanations to all elimination entries. We have already provided substantial information regarding this topic. Providing all this information is too time consuming and unduly burdensome." (OC-79). Response received on January 10, 2003.

³⁷ Interview notes: David Robbins, November 21, 2002 (No. 6).

³⁸ Interview notes: David Robbins, November 21, 2002 (No. 5).

a third affiliate rather than billed directly.³⁹ Charges to the ASB were not documented in a formal inter-company bill or summarized in any other format.⁴⁰

Monthly itemizing of inter-company charges greatly enhances the transparency and auditability of affiliate transactions, thereby improving control and limiting the opportunity for mis-charges. Monthly itemizing does not mean that inter-company bills must be prepared and printed out on paper. Often, the same spreadsheets used to develop inter-company allocations and journal entries can be used to send an itemization of charges from each charging or allocating affiliate to the manager or cost accountant responsible for the charges in each billed subsidiary.

4. Inter-company Service Agreements - Inter-company service agreements document the nature, terms and prices for inter-company services. In showing what affiliates are receiving from one another and at what price, service agreements enhance control by limiting opportunities for mistakes and misunderstandings. Inter-company agreements increase the transparency of inter-company transactions, enhancing the ability to understand and audit them. SJI and SJG had inter-company service agreements with various affiliates at the end of the audit period.⁴¹
5. Affiliate Transaction Procedures - When asked to provide affiliate transaction procedures, SJI referred us to SJI's Cost Allocation Manual (CAM).⁴² Inter-company service agreements also referenced the CAM for pricing support.⁴³ Our review of the CAM indicated that it was prepared from a "bottoms-up" perspective. Different types of transactions had their own unique allocation procedures, oftentimes described in minute detail. As long as management had the foresight to predict every possible type of cost that might occur, such a system might conceivably work. However, in reality, such a piecemeal approach is susceptible to errors of omission. Since SJG pays the majority of SJI's common costs, by default it will be the recipient of much of the costs that are misallocated when allocation procedures are not properly applied. In addition, the CAM often lacks the support necessary to determine the source of allocation factors used. While SJI's CAM is better than no documentation at all, significant additional work is necessary for it to be an effective tool in applying affiliate transaction procedures.
6. Inter-company Transaction Payment and Settlement - According to management, inter-company payable and receivables are settled on a monthly basis.⁴⁴ A review of the consolidating balance sheets for SJI indicates that inter-company payable and

³⁹ Interview notes: David Robbins, November 21, 2002 (No. 22) and review of OC-11.

⁴⁰ Interview notes: Thomas Kavanaugh, January 14, 2003 (No. 3).

⁴¹ OC-17.

⁴² OC-2.

⁴³ OC-17.

⁴⁴ Interview notes: David Robbins, November 21, 2002 (No. 7).

receivable balances for operating entities were not growing steadily over time.⁴⁵ This evidences the periodic settlement of inter-company amounts due, an important element in the overall accounting control of affiliate transactions and a necessary component of accurate subsidiary financial statements.

B. Compliance with Director and Officer Requirements

Affiliate Standards indicate that corporate officers and board members may not serve both the utility and its competitive services affiliates. Affiliate Standards 14:4-5.5 (q) states:

An electric and/or gas public utility and the [public utility holding company] PUHC or related competitive business segments of its public utility holding company shall not have the same persons serving on the Board of Directors as corporate officers, except for the following circumstances:

1. In instances when these standards are applicable to public utility holding companies, any board member or corporate officer may serve on the holding company and with either the electric and/or gas public utility or a related competitive business segment of the public utility holding company, but not both the electric and/or gas public utility and a related competitive business segment of the public utility holding company.

The following table shows the directors and officers for SJL as well as several of its operating companies:

⁴⁵ OC-79.

Table 2-1 South Jersey Industries Directors and Officers						
	SJI	SJG	SJE	SJRG	ME	MAS
	Holding Company	Gas Utility	Retail Affiliate	Wholesale Affiliate	Project Developer	Retail Affiliate
Directors						
Charles Bisciegia	■	■				
Shirli M. Billings, Ph.D.	■	■				
Keith Campbell	■		■			
W. Cary Edwards	■		■			
Thomas L. Glenn, Jr.	■		■			
Sheila Hartnett-Devlin	■	■				
William J. Hughes	■	■				
Clarence D. McCormick	■	■				
Frederick R. Raring	■	■				
Herman D. James, Ph.D.	■		■			
Edward J. Graham			■			
Officers						
Charles Bisciegia	■	■				
Edward J. Graham	■		■	■	■	
David A. Kindlick	■	■				
Albert V. Ruggiero	■	■				■
Richard H. Walker, Jr.	■	■		■	■	■
Michael J. Renna	■		■		■	
J.F. Kelly	■		■			
Richard J. Jackson		■				
Janet T. Nickels		■				
Charles F. Dippo		■				
Patrick T. Finnigan		■				
Samuel A. Pignatelli		■				
S.H. Clark		■				
Thomas S. Kavanaugh		■				
Bonnie J. Bornstein		■				
Jeffrey E. DuBois		■		■		
Anthony M. Tetto		■				
Dave Robbins			■	■	■	
J. A. Rodio			■			
Notes: 1. The companies above are as follows: SJI - South Jersey Industries SJG - South Jersey Gas SJE - South Jersey Energy Source: OC-61 SJRG - South Jersey Resources Group ME - Marina Energy MAS - Millennium Account Services						

Analysis reveals that two SJI Officers (Albert Ruggiero, Executive Vice President and Chief Administrative Officer and Richard Walker, Corporate Secretary and Corporate Counsel) and

one SJG officer (Jeffrey DuBois, Assistant Vice President, Gas Supply and Off-System Sales) serve as officers for both the utility and non-regulated affiliates.

Mr. Ruggiero serves as an officer for SJI, SJG, and Millennium (for purposes of this discussion, Executive Committee members of Millennium are considered officers rather than board members). Mr. Walker serves as an officer for SJI, SJG, SJRG, Marina, and Millennium. Mr. DuBois serves as an officer for SJG and SJRG. The non-utility affiliates of concern include SJRG, a wholesale affiliate, and Millennium, a retail affiliate. To the extent these non-utility affiliates are considered to provide "competitive services" as defined by the BPU, the participation of Mr. Ruggiero, Mr. Walker and Mr. DuBois as corporate officers is at variance with Affiliate Standards. If "competitive services" are limited to "retail" services, Mr. DuBois' officer role with SJRG is *not* at variance with the Affiliate Standards.

C. Prior Audit Recommendation Implementation Assessment

The following is an assessment of the implementation of the recommendations made in the Schumaker & Company (Schumaker) audit report dated October 16, 2000 and accepted by the BPU:

1. II-1: Resubmit the SJG Compliance Plan after incorporating the findings and conclusions of this report

In March, 2002, SJG submitted a letter to the BPU which stated that it did not find a need to update its Compliance Plan until later in the year. On February 25, 2003, SJG submitted its updated Compliance Plan to the BPU. BPU staff has indicated that it was satisfied with SJG's actions during 2002 and 2003 in complying with this recommendation.

2. III-1: Reorganize SJI in such a manner that no individuals serve as directors or officers for both the regulated and non-regulated entities

SJG management does not believe that Millennium is a competitive business segment and, as a result, does not believe that the Affiliate Standards requiring strict separation of board memberships and officers between the gas utility and a competitive business segment applies. The BPU Staff's interpretation of the Affiliate Standards is that Millennium does meet the definition of a competitive business segment. Two individuals of SJG serve as officers for both SJG and Millennium. Should the BPU determine that Millennium is not a competitive business segment subject to Affiliate Standards, SJG would have successfully implemented this recommendation. However, if the wholesale gas affiliate was to be determined to offer "competitive services", a third individual would be at variance with the Affiliate Standards.

3. III-2: Establish specific mechanisms and procedures within SJG to ensure that it complies with the Affiliate Standards for shared officers and directors

The audit report does not explain what it means by "specific mechanisms and procedures". SJI states in its Compliance Plan that "SJG has adequate processes in place to implement this rule (5.7.b.1)." However, this assumes that SJG management is correct in concluding that Millennium is not subject to the Affiliate Standards concerning shared officers and directors. Should the BPU determine that Millennium is a competitive business segment subject to the

Affiliate Standards, SJG would have failed to implement this recommendation. The same would be true if SJRG would be found by the BPU to be a competitive business segment.

4. III-3: Document the provision of support services between SJI and SJG through the implementation of contracts and services agreements

SJI has satisfied this recommendation. The Company developed shared services contracts for services between SJI and SJG, as well as shared services contracts for services between SJG and other SJI subsidiaries.

5. IV-1: Establish procedures to ensure and document regulatory compliance for asset transfers, leases, or rentals

SJI has satisfied this recommendation. SJI established procedures to ensure and document regulatory compliance for asset transfers, leases and rentals.

6. V-1: Establish policies within SJG and its affiliates to ensure that employee transfers are consistent with the Affiliate Standards

SJI has satisfied this recommendation. SJI/SJG established employee transfer policies.

7. V-2: Develop a method of apportioning pension costs within SJI between affiliates for employees who transfer

SJI has satisfied this recommendation. SJI consulted with its actuary and developed an apportionment method for the pension costs related to employees transferred between affiliates.

8. VI-1: Update operating procedures for accumulation, assignment, and allocation of costs involving affiliates and competitive service segments of South Jersey Gas Company

SJI has satisfied this recommendation. As a part of this recommendation, Schumaker noted that the Company should develop a cost allocation manual, update it annually and use it to train managers. SJI developed a cost allocation manual during the audit period. See below for additional detail regarding SJI's cost allocation manual.

9. VI-2: Initiate a project to unify the cost allocation development and modification process under a single point of focus

SJI has satisfied this recommendation. The Company named an individual as a coordinator to oversee development and revision of SJI's CAM. It must be noted, however, that the "unification" of the cost allocation process does not ensure that SJI's cost allocations produce fully-allocated cost results, nor does it ensure the adequacy of the CAM in documenting and controlling cost allocation procedures. In this respect, SJI's CAM currently fails to satisfy its intended purpose.

10. VI-3: Develop a formalized SJI/SJG cost allocation policy

This recommendation is essentially the same as Recommendation VI-1. As noted above, SJI developed a “formalized” cost allocation manual. Therefore, SJI has satisfied this recommendation. However, the SJI CAM does not provide an “overall allocation framework” to implement SJI’s allocation methodology. The CAM addresses cost allocations in a piecemeal manner. In some places the manual is extremely specific while in others its descriptions are vague. As noted above, SJI’s CAM does not currently satisfy the objective of adequately documenting and controlling cost allocation procedures. SJI’s entire CAM and associated allocation procedures need to be redeveloped from a top-down perspective to ensure full allocation of all costs while using an attributable cost methodology to ensure the proper allocation results. This is described in Chapter 1 under the heading Audit Recommendations.

11. VI-4: Develop and implement a new procedure for allocating corporate and other overhead charges between appliance service and utility distribution work to replace the current 60%/40% scheme

SJG re-vamped its allocations to the Appliance Service Business (ASB) since the last audit. Allocations are made on the basis of a number of different factors including the three-factor formula, time and effort, and other activity-based factors. While SJG has satisfied this recommendation, compliance does not ensure reasonable allocations as further documented in this report.

12. VI-5: Ensure that a cost allocations audit of affiliates and competitive service segments of SJG is performed in a timely manner

SJG has partially satisfied this recommendation. Schumaker recommended that an audit be completed during 2001. SJG’s Internal Audit Department did complete an “Affiliate Relations Review” in May, 2002. However, it does not appear that the review addressed cost allocations in a detailed manner. Therefore, the “audit” was completed later than recommended and did not thoroughly examine the Company’s cost allocations. For example, it did not successfully identify the problems with cost allocations found during our audit.

13. VI-6: Correct deficiencies noted by Schumaker & Company in sampling of transactions and ensure that sufficient information is included in cost allocation manual to prevent these deficiencies from happening in the future

This recommendation relates to numerous points made by Schumaker as a result of detailed audit testing. It is difficult to address SJI’s corrections for each specific deficiency noted. The main area of concern addressed by Schumaker related to timekeeping. This area is addressed in SJI’s CAM. In limited testing of this area, we noted that problems related to timekeeping still exist in certain departments. However, we cannot conclusively determine if SJI satisfied or did not satisfy this recommendation.

D. Audit Analysis of Cross-Subsidization

One of the key audit objectives listed in the BPU’s Request for Proposal is to determine whether competitive services are cross-subsidized by utility services. The Affiliate Standards define cross-subsidization as follows:

“Cross subsidization” means the offering of a competitive product and / or service by [a] . . . public utility, or the offering of a product and / or service by an affiliate, which relies in whole or in part on the utilization of utility employees, equipment or other assets, and for which **full compensation** (via cost allocations or direct payment), as determined by the Board, has not been provided for the use of such . . . public utility assets, resulting in the inappropriate transfer of benefits from the utility ratepayers to the competitive product and / or service or affiliate [Emphasis added].

In order to evaluate cross-subsidization, we needed an objective benchmark to measure “full compensation”. The only benchmarks available in the Affiliate Standards are the transfer pricing limitations established by market price and fully allocated cost, each of which may be applicable depending on circumstances. Taking circumstances into account (for example, whether an affiliate service was offered for sale on the open market), we used market price and fully allocated cost as the basis for assessing the existence of, and, when possible, calculating cross-subsidies.

Fully Allocated Cost

It is necessary to have a working definition of fully allocated cost in order to apply it to a test of cross-subsidization. As defined by Affiliate Standards, fully allocated cost includes

- \$ Allocations of direct, indirect and other economic costs of assets utilized; and,
- \$ Costs incurred directly or indirectly in providing competitive services.

In general, we interpreted “costs of assets utilized” to include depreciation and return (debt and equity return at the utility’s allowed rate of return adjusted for associated income tax) on assets employed, and rent paid to lease assets owned by others, including affiliates. In cases in which an affiliate’s “assets employed” were insignificant or in which the affiliate did not earn a profit, we ignored return on investment. We interpreted “costs incurred directly or indirectly” to include direct labor and associated benefits and payroll taxes, utilities, supplies, parts, vehicle operations and a share of the operating costs of shared utility and corporate functions calculated using an attributable cost allocation methodology.

Determining the Source of Cross-Subsidies

We also applied the following rules in defining and assessing the source of cross-subsidies:

- \$ Subsidies Evidenced by Financial Losses - To the extent an affiliate lost money, its losses are considered to have been provided by its parent company and shareholders. Thus, affiliate losses are deemed to be a cross-subsidization by shareholders. In general, we were able to quantify these cross-subsidies when available financial results showed losses.
- \$ Subsidies Evidenced by Unrecognized and Underestimated Affiliate Charges - To the extent an affiliate was not charged or under-charged for the utility and corporate functions that served it, the under-charged or under-allocated amount was a cross-subsidy provided by the other affiliates (mostly the utility) to which the costs were

alternatively charged. We used attributable cost as the basis for assessing whether the allocation methodology was likely to have produced this cross-subsidy; however, in most cases involving allocations in which attributable cost was not properly used, it was not possible to quantify the amount of the cross-subsidy.

\$ Intra-Affiliate Subsidies Created by Price Discrimination (Appliance Services) - We considered whether price discrimination within the appliance services business (evidenced by certain promotions and discounts) created cross-subsidies between groups of customers within the business unit or between customers and the parent company's shareholders. For example, senior-citizens discounts can represent a cross-subsidization of older customers by younger ones, or a cross-subsidy of older customers by the parent company's shareholders. Discounts for new appliance service customers, including free service contracts provided for some period of time, can represent a cross-subsidization of newer customers by existing customers, or a subsidy by shareholders.

We believe the test of whether subsidies created by discounts are reasonable under Affiliate Standards is whether the appliance unit is profitable overall. If it is profitable, then its prices on average are sufficient to cover its costs and it is logical to view discounts as subsidies between customer groups *within* the business unit. Discounts and promotions not designed to drive out competition are legal and widely practiced across the entire spectrum of retail businesses. However, it is not reasonable to paint all discounts and promotions with the same brush. Although we did not find evidence of excessive or predatory discounting in the gas appliance businesses we reviewed, such practices could occur even when the appliance business is profitable. As such, the BPU should consider the circumstances surrounding appliance services discounts and promotions to determine that they are not designed to drive competitors out of a market.

Chapter 3 - South Jersey Gas Common Cost Allocations

Chapter 3 - Cost Allocations

I. Introduction

SJI's regulated and unregulated subsidiaries share certain functions and costs. Shared costs originate primarily at the regulated utility, SJG, but also at the parent, SJI. During the last audit of competitive service offerings, the auditor recommended and the BPU accepted the development of formalized SJI/SJG cost allocation policies. Affiliates Task Force I was formed to carry out this recommendation -- the end result being the SJI Cost Allocation Manual (CAM).¹ This chapter covers the common costs and related allocation procedures as documented in the CAM.

II. Summary of Audit Findings

A. General Problems with Cost Allocations

SJI's cost allocation process was developed from a bottom-up perspective. Most allocations of costs were performed on a transaction-by-transaction basis. Numerous allocations documented in the CAM did not have adequate support. SJG could not provide basic information including, but not limited to, employee headcount information from prior years and useable electronic general ledger data. Neither SJI nor SJG employed a management accounting system that segregated costs by department, responsibility center or cost center. All of these factors hindered our ability to review the cost allocation process employed by SJI and, more importantly, to quantify any mis-allocations of costs.

B. Organizational Misalignment of Shared Corporate Services

Most corporate shared services were housed in the regulated utility, SJG, rather than the parent, SJI. If tightly controlled, such an organizational arrangement would not necessarily result in cost allocation problems. However, we noted instances in which this misplaced "assignment" of functions within SJG likely directed costs to SJG instead of the proper affiliates. Some examples of this included the utilization of exception time reporting by the corporate Human Resources Department housed within SJG, the allocation of certain insurance premiums based on employee headcounts by entity, and the allocation of support costs using a three-factor formula -- one equally-weighted factor being payroll.

C. Transfer Pricing of Information Services Programming

The Information Services Department charged its programming time to internal users by employing two different hourly rates, one for mainframe programming and one for PC-based programming. Neither of these two rates adequately accounted for all costs attributable to offering these professional services. In addition, both rates were well below benchmark rates observed by us in New Jersey and other locations throughout the country.

¹ Interview notes: David Kindlick, October 9, 2002 (No. 5).

D. Facilities Allocations

Using the limited data provided to us concerning facilities, we do not believe the allocation of facilities costs at Folsom, New Jersey was reasonable in 2001.² In our opinion, both SJI and SJE should have been allocated a greater percentage of the overall costs while SJG should have been allocated less.

E. Three-Factor Formula

SJI allocated some support and general corporate services to affiliates on the basis of a three-factor formula (assets, payroll, and gross margin).³ The three-factor formula is not an attributable allocation methodology and, when initially established, is subject to management subjectivity. SJI's three-factor formula, in particular, is not sound for a variety of reasons including the inherent bias of the historical asset factor towards the capital-intensive regulated utility.

F. Allocations of Labor Cost by Automated Dispatching System (ADS)

Time allocations of labor costs to the Appliance Service Business (ASB) for utility technicians performing appliance repair service based on time entered into the automated dispatching system is generally consistent with attributable cost principles.

III. Audit Analysis**A. Background on Attributable Costs**

Most regulatory commissions in the United States require utilities to fully distribute or fully allocate, common costs between regulated and non-regulated activities. To the extent possible, fully allocated costs should be linked to cost objectives based on causation; that is, subsidiaries should incur a share of common costs proportional with the costs they cause to be incurred.

An attributable cost allocation procedure is guided by the following principles:

- C Costs should be directly assigned to cost objectives when possible.
- C Costs that cannot be directly assigned should be assigned to homogenous cost pools (groupings of costs that can be logically attributed on a similar basis). When possible, costs in these cost pools should be allocated based on direct analysis of the origin of the costs.
- C When direct analysis is not possible, costs should be allocated based upon an indirect, cost-causative linkage to another category.

² For purposes of this test, we made no adjustment to the assignment of shared corporate service employees among the entities.

³ This was the case in 2002. In 2001, these same costs were allocated on the basis of an asset factor only.

- C When direct and indirect analysis is not possible (as is the case with certain corporate governance costs, such as investor relations), the costs are “residual” and should be allocated based upon the combined ratio of all other costs directly assigned, directly allocated and indirectly allocated.

B. General Problems with SJI’s / SJG’s Cost Allocations

1. Misplaced Focus of the Allocation Process on Individual Transactions

A review of the CAM quickly revealed that it was developed from a bottom-up perspective. A perfect example of this was CAM Procedure M-2 which explained how catering costs for Board of Directors’ meetings should be allocated.⁴ According to the SJG Controller, many allocations were, in fact, prepared on a transaction-by-transaction basis during the audit period.⁵ Such a system, in addition to adding an unnecessary layer of complexity to maintaining the CAM, is susceptible to error for any number of reasons including clerical miscalculations of allocation factors, inconsistent handling of similar transactions by different employees and perhaps, most importantly, the potential that costs will not be allocated at all if they don’t fit neatly into one of the cost categories identified in the CAM. A properly developed allocation system is designed from the top down so that management can obtain assurance that all costs are captured in the process.

2. Lack of Support for Allocations

In response to our request for the SJI / SJG corporate cost allocation model and underlying support, SJG management referenced the SJI CAM.⁶ However, in many cases, the CAM did not provide the information necessary to determine the sources of the summarized data or to

⁴ OC-2.

⁵ Interview notes: Thomas Kavanaugh, October 10, 2002 (No. 9).

⁶ OC-7.

assess the overall reasonableness of the calculations.⁷ When we made attempts to obtain this information, SJG was unable to respond in a timely manner.⁸

3. Lack of Management Accounting System

SJI and SJG did not employ a management accounting system that segregated costs by department, responsibility center, or cost center during the audit period (except in rare instances). Executive management attributed this deficiency to the outdated accounting systems now used by SJG.⁹ As a result, we were not able to quantify the costs associated with each significant shared corporate service (e.g., human resources, accounting, etc.) and neither could SJG's accounting department.¹⁰ Lack of such a system may be the primary reason that SJI and SJG did not pool common costs for allocation purposes but, instead, allocated costs primarily on a transaction-by-transaction basis.

4. SJG's Outdated Accounting System Could Not Produce Useable Electronic Data

SJG's accounting system was developed in the mid-1970's with the assistance of IBM.¹¹ We requested general ledger detail in electronic format. However, in response to this data request, SJG provided two different types of electronic files. The first files provided were the equivalent of a "snapshot" of the data in text format. When we explained that this format was not conducive to any meaningful analysis, SJG provided a supplemental response in spreadsheet format but in such a disorganized manner that it was totally unuseable (for instance, a number such as "1,500,075" was shown as three different amounts -- "1" and "500" and "075").¹² On January 10, 2003, we received a follow-up response from SJG that said¹³:

⁷ Two prime examples of this are the three-factor formula (OC-2: C-1) and benefits and payroll tax allocation (OC-2: B-3) "support". The SJI CAM provided no tie-out to either the general ledgers or the financial statements of its various affiliates for any of the individual factors used in the three-factor formula. Our attempt to independently verify the "asset" factor were frustrated by the lack of this information.

While the detailed calculation of the benefits and payroll tax allocation were based on forecasted expenses, SJI/SJG provided no general ledger account information in the CAM that would permit us to compare the forecasts to the actual expenses incurred.

⁸ Interview notes: Thomas Kavanaugh, January 14, 2003 (No. 11) and e-mail correspondence from us to Richard Walker on January 21, 2003. 2001 data was provided on January 23, 2003. 2002 data could not be located and provided until January 30, 2003.

⁹ Presentation by Executive Management, October 31, 2002 (No. 19).

¹⁰ OC-137.

¹¹ OC-113.

¹² OC-40 and OC-44.

¹³ OC-44.

Have tried several times to provide requested data electronically; data is not available without substantial time and effort to create electronic files; request is too burdensome with which to comply.

We did not anticipate that a request for such basic information could not be accommodated by SJG. Time constraints did not permit us to re-format the data. Without the ability to sort and summarize data from SJG's general ledger, we were severely restricted in our ability to analyze the allocations of hundreds if not thousands of individual transactions occurring during the audit period.

C. Shared Corporate Services Costs

Although SJI provided a few common functions to its subsidiaries and associated business segments during the audit period, most typical shared corporate services were provided by departments within the regulated utility, SJG. Since SJI and its subsidiaries did not employ a management accounting system that segregated costs by departments, cost centers, or responsibility centers (except in rare instances), neither we nor SJG's accounting department could quantify the costs associated with each shared corporate service.¹⁴ However, we believe the following table summarizes some of the more significant shared corporate services and the legal entity in which they are located:

Table 3-1 SJI and SJG Shared Corporate Services 2002	
Service	Legal Entity
Executive Management	SJG *
Finance / Cash Management / Accounting	SJG **
Human Resources	SJG
Payroll	SJG
Information Technology	SJG
External Relations	SJG
Internal Audit	SJG
Marketing	SJI
Shareholder Services / Investor Relations	SJI
Corporate Secretary / Corporate Counsel	SJG / SJI ***
Notes: 1. Table based primarily on origination of payroll charges of administrative employees. Accounts payable activity may not coincide with this categorization.	
Sources: OC-13, OC-25, OC-80 and various interview notes	
* Two members of executive management are SJI employees.	
** SJI also has a small financial reporting / accounting department.	
*** 1 employee is an SJG employee; 1 employee is an SJI employee.	

¹⁴ OC-137.

As the preceding table indicates, most shared corporate service functions were maintained within SJG, rather than SJI as would be expected of functions that benefit the corporation as a whole. As a result, cost allocations that were either directly or indirectly affected by this misalignment came under particular scrutiny. These will be discussed in further detail below.

Given the limited, useful general ledger data that we were able to obtain from SJG, we relied primarily on affiliate invoices for accumulating most information in this chapter. Following are discussions of some of the more significant allocations of shared corporate services.

1. Allocation of Salaries and Wages

Most shared corporate services costs associated with the salaries and wages of officers, management and other general office personnel were directly assigned to affiliates and related competitive business segments based on hours reported on employee time sheets.¹⁵ If properly designed and administered, such a system would be an acceptable method of assigning costs to the appropriate SJI subsidiaries. However, we have the following concerns regarding these costs:

- C Employees must accurately account for their time in order for this process to work correctly. In our limited testing of the employee time sheets, we identified an entire department that did not appear to be charging the appropriate affiliate for the work it performed.¹⁶
- C During the audit period, SJI's CAM had provisions which allow employee time to be "automatically" allocated based on pre-arranged allocation factors.¹⁷ To the extent that employees or management did not take steps to override this allocation when it was not warranted, costs could have been assigned incorrectly to SJI subsidiaries.
- C While the CAM implied that positive time reporting was mandatory,¹⁸ we were told by the Director of Human Resources that she personally accounted for her time on an exception time basis and she believed that others in the SJI organization accounted for

¹⁵ OC-2 (Sections T-13 and T-8).

¹⁶ Per review of the time sheets submitted in response to OC-80, we counted less than seven hours of total time charged by the Human Resources Department to Millennium Account Services LLC (Millennium), the meter-reading affiliate, for the first nine months of 2002. SJI and (by default) SJG was designated the "human resources partner" of this joint venture. Although we have no way of ascertaining the exact number of hours that the Human Resources Department spent, we are skeptical that the reported time reflects the actual time spent considering this department is presumably responsible for the administration of Millennium employee benefits, hiring of employees, etc. Although SJG management claims that Human Resources Department time could not be charged to Millennium (contrary to its most recently signed Administrative Services Agreement), this should not have a bearing on the accurate recording of employee time.

¹⁷ OC-2 (Sections T-10 and T-13 (Exhibits B and D)).

¹⁸ OC-2 (Section T-13 (Exhibits B and D)).

their time in the same way.¹⁹ In other words, time automatically defaulted to the company to which the employee was employed (almost always SJG) unless an “exception” was noted. This would not necessarily be a problem except that (as demonstrated in Table 3-1 above) many employees were assigned to shared corporate services departments which were located in the regulated utility (SJG) rather than the parent (SJI). Corporate efforts not specifically assigned to a particular cost objective should not automatically default to SJG.

We asked SJG to provide a list of all shared services functions that used exception time reporting during the audit period. SJG did not directly respond to our question.²⁰

- C To the extent that costs of employee time were assigned to any cost pool allocated on the basis of the three-factor formula, the costs were not allocated on an attributable basis.

Based on a review of the affiliate invoices and the time sheet summaries retained by the Accounting Department, we summarized the allocation of employee salaries and wages of shared corporate services (see following table):

¹⁹ Interview notes: Sharon Pennington, December 12, 2002 (No. 6).

²⁰ OC-141.

Table 3-2 Allocation of Shared Corporate Services Salaries & Wages (Rounded to 000's)					
Cost Objective	Origination of Payroll			% of Time Allocated (w/o Corp)	% of Time Allocated (w/ Corp)
	SJG	SJI	Total		
12 Months Ended 12/31/01:					
SJG	\$ 4,419,000	\$ 235,000	\$ 4,654,000	84.0%	73.7%
SJE	71,000	546,000	617,000	11.1%	9.8%
ASB	102,000	7,000	109,000	2.0%	1.7%
SJRG	30,000	20,000	50,000	0.9%	0.8%
Marina	21,000	30,000	51,000	0.9%	0.8%
Millennium	10,000	3,000	13,000	0.2%	0.2%
Other	30,000	21,000	51,000	0.9%	0.8%
Sub-Total	4,683,000	862,000	5,545,000	100.0%	87.8%
SJI - Corporate (A)	425,000	347,000	772,000	N.A.	12.2%
Total	\$ 5,108,000	\$ 1,209,000	\$ 6,317,000	N.A.	100.0%
9 Months Ended 9/30/02:					
SJG	\$ 3,640,000	\$ 175,000	\$ 3,815,000	81.9%	70.4%
SJE	63,000	516,000	579,000	12.4%	10.7%
ASB	73,000	12,000	85,000	1.8%	1.6%
SJRG	31,000	30,000	61,000	1.3%	1.1%
Marina	32,000	47,000	79,000	1.7%	1.5%
Millennium	5,000	-	5,000	0.1%	0.1%
Other	22,000	13,000	35,000	0.8%	0.6%
Sub-Total	3,866,000	793,000	4,659,000	100.0%	86.0%
SJI - Corporate (A)	444,000	313,000	757,000	N.A.	14.0%
Total	\$ 4,310,000	\$ 1,106,000	\$ 5,416,000	N.A.	100.0%
Notes: 1. Excludes immaterial amount of time charged by SJG employees to Merch, Other, etc. (A) Includes SJI payroll time charged to "Other"					
Sources: OC-11, OC-80, and audit analysis					
Legend: SJE = South Jersey Energy, ASB = Appliance Service Business, SJRG = South Jersey Resources Group, Marina = Marina Energy, Millennium = Millennium Account Services					

If the time turned in by these shared corporate service employees was accurate²¹, we believe that the preceding table provides a much more meaningful benchmark to allocate "residual" corporate costs than the company's three-factor formula (to be discussed later in this chapter).

²¹ "Shared corporate service employees" was defined loosely to include such departments as SJI's Sales Department which more properly should have been assigned to SJE. If organizational adjustments such as these had been made to the analysis, the results would have been materially impacted.

2. Allocation of Information Services' Programming Time

During the audit period, rather than allocate the salaries and wages of Information Services' programmers in the same manner as all other shared corporate services employees, SJG calculated a transfer price for use in billing these services. The transfer price used to charge mainframe programming time was \$64 per hour in 2002 (\$68 per hour in 2001). The transfer price used to charge PC-based programming time was \$50 per hour in 2002 (\$45 per hour in 2001).²² The CAM only included a high-level summary of the calculation of the hourly rate for 2002 in both cases.

While not provided enough information to audit the calculated rates, several observations of the calculation are noteworthy:

- C The costs included in the 2002 hourly rate calculations for both mainframe and PC-based programming only included costs associated with salaries, wages and benefits. Such a calculation does not properly attribute all costs associated with offering these computer programming service. Costs of facilities, office supplies, administrative support, etc. must be "attached" to the hourly rate in order to accurately account for the true cost of supplying the service to end users. To do otherwise creates a system in which costs are not fully allocated.
- C As a benchmark, we reviewed the hourly rates charged by another New Jersey-based gas utility which has a theoretically more sound attributable cost system. This utility charged at least \$140 per hour for applications and software development costs during a similar time period. In addition, it has been our experience that hourly rates charged by utility professionals containing an appropriate share of overheads generally range from \$125 to \$150 per productive hour. For these reasons, we do not believe that the transfer prices established by SJG for programming services adequately allocates costs on an attributable basis.

3. Allocation of Employee Benefits

We were unable to determine the precise method in which SJI/SJG allocated employee benefits of shared corporate service employees based on the procedures documented in the CAM and the limited support provided to our audit requests. Procedures documented in the CAM imply that the same employee benefits may have been allocated twice -- once in the overall hourly benefit rate calculation and another time in the individual allocations of the various benefits such as the health care plan, 401(k) plan, etc.²³

²² Interview notes: Patrick Finnigan, October 30, 2002 (No. 10) and OC-2 (Sections T-9 and T-12).

²³ Management represents that benefits were not allocated twice and intends to revise its CAM to eliminate any potential confusion (SJG comments to draft report).

4. Allocation of Insurance

During the audit period, allocations of costs for corporate insurance were largely based on “insurance underwriting norms that the insurance carriers use[d] in determining premiums for clients.”²⁴ While the allocation methodology generally appeared reasonable, any insurance costs that were driven by employee counts such as insurance for employment practices, fiduciary and workers compensation would be improperly skewed towards SJG to the extent that shared corporate services functions were placed within SJG rather than SJI. Based on a review of the CAM, the total cost of these three policies was estimated to be \$866,877 in 2002.²⁵ Similar problems would result from the sales force located in SJI that primarily served SJE during the audit period.²⁶

5. Allocation of Facilities

During the audit period, SJI / SJG operated seven primary facilities within its service territory.²⁷ In response to a detailed request for information concerning the allocation of facilities, SJG provided brief summaries of the costs of operating each of the facilities (including utilities, custodial service, maintenance, depreciation, etc.) and an associated calculation of cost per square foot.²⁸ SJG did not, as requested, provide building maps, leases, electronic spreadsheets, etc. that could be used to determine the accuracy of the summarized calculations. SJG represented that it was unable to produce detailed employee listings for past periods.²⁹ As a result, we were severely restricted in our ability to determine the reasonableness of the allocation of shared corporate service facilities costs. Without the ability to analyze the actual square footage used by each entity and the specific treatment of common areas utilized by all employees, we performed a reasonableness test of facilities cost based on current employee headcount (the only information made available by SJG). The following table summarizes our analysis regarding the Folsom corporate headquarters.

²⁴ OC-2 (Representative example is Section I-6).

²⁵ OC-2 (Employment practices: \$45,150; fiduciary: \$38,249; and workers compensation: 783,478.)

²⁶ Interview notes: Thomas Kavanaugh, November 1, 2002 (No. 4).

²⁷ OC-39 and Service Area Map distributed by Executive Management on October 31, 2002. Facilities were located in Folsom (corporate headquarters), Glassboro, Millville, Swanton, Pleasantville, McKee City, and Waterford.

²⁸ OC-39.

²⁹ OC-25.

Table 3-3 Folsom Office Allocation of Facilities Costs in 2001 Reasonableness Test				
Description	No. of Employees	% of Total	Estimated Reasonable Facilities' Allocation	Actual Facilities' Allocation
SJG (A)	222	86.0%	\$ 1,010,014	\$ 1,114,494
SJI	26	10.1%	118,618	32,186
SJE	10	3.9%	45,803	27,755
Total	258	100.0%	\$ 1,174,435	\$ 1,174,435
Notes: 1. Assumes that average square footage per employee for each entity is equal. Any upward bias to this calculation due to the "assignment" of many executives to SJG is offset by departments such as the SJG Customer Care Center which has relatively limited space per employee. (A) Adjusted for 9 part-time employees. Sources: Derived from OC-11, OC-25 (assumed that "General Office" = Folsom, NJ), OC-39				

Part of reason for the difference between our calculation and SJG's calculation was that SJG used year-old data in performing its calculation. However, this had much less to do with the results than SJG's decision to only allocate 2.8% and 2.4% of the rentable square feet during 2001 to SJI and SJE, respectively.

Using information made available to us, a similar analysis of the McKee City facility would seem to indicate that the ASB should have been allocated approximately 20% of the square footage (six ASB customer call center / dispatch employees out of 30 total employees) rather than the 9% it actually was charged (934 sq ft / 10,271 sq ft).³⁰ However, given the nature of the jobs being performed with associated space requirements, it is possible that the space assigned to the ASB employees was reasonable.

We would not expect similar discrepancies to exist at other SJG-operated facilities because they were used almost exclusively for SJG business. However, the apparent problems noted by us at Folsom and McKee City suggest that the calculations as performed by SJG require modification.

As has been noted previously, to the extent that shared corporate services employees were "assigned" to SJG rather than SJI, allocations based on square footage or headcount will be drawn inappropriately to SJG.

³⁰ ASB employee headcounts obtained from interview notes: Robert Fatzinger, October 29, 2002 (No. 17). Total employee headcount at McKee City derived from OC-25. Square footage information concerning McKee City obtained from OC-39.

6. Allocation of Management Service Fee / Corporate and Fiscal Costs

As described in the SJI CAM, the “operating costs incurred by SJI necessary to provide support services to subsidiaries . . .” and the “costs for general corporate services including; Corporate Secretary costs, shareholder record costs, investor relations costs, and external relations costs”³¹ were allocated to SJI subsidiaries and the ASB using size-based allocators during the audit period. Since the types of costs involved were very similar in nature (e.g., support services benefitting the entire organization as a whole), we chose to analyze the services together. A summary of these costs as allocated by SJI during 2001 and the first nine months of 2002 is provided in the following table:

Table 3-4 SJI Allocation of Management Service Fee and Corporate and Fiscal Costs				
Cost Objective	12 Months Ended 12/31/01	% of Total	9 Months Ended 9/30/02	% of Total
SJG	\$ 2,112,433	98.0%	\$ 934,700	91.4%
SJE	43,649	2.0%	30,338	3.0%
SJRG	-	0.0%	23,775	2.3%
SJI (A)	-	0.0%	15,000	1.5%
ASB	-	0.0%	15,213	1.5%
Marina	-	0.0%	3,239	0.3%
	\$ 2,156,082	100.0%	\$ 1,022,265	100.0%
Notes: 1. %'s may be slightly different from company intentions due to prior year corrections. 2. 2002 data includes Prudential insurance de-mutualization proceeds that offset gross expenses. (A) Estimate based on memo included as Exhibit A of Section C-1 of CAM.				
Sources: OC-11 and OC-2				

In 2001, SJI employed an asset-based allocator derived from July 31, 2000 balances. The prior auditors correctly questioned the rationale behind such an allocator and in 2002, SJI modified its approach to equally weight assets, payroll, and gross margins (the three-factor formula). Each of these factors was measured as of June 30, 2001 with the payroll activity factor being based on a 6-month period and the gross margin activity factor being based on a 12-month

³¹ OC-2 (Sections C-6 and C-1).

period.³² The supporting workpapers for the development of the 2002 factors were not received until the day before the draft report was due because they were misplaced.³³

SJI's three-factor formula methodology is not an attributable allocation methodology. It is based on an arbitrarily selected set of size-related factors (assets, payroll and gross margin). Since SJG is capital-intensive and has had decades to accumulate the lion's share of SJI's asset base and since SJI has "assigned" shared corporate service functions to SJG rather than SJI, the factors SJI selected for its three-factor formula produce higher cost allocations to SJG than most other equally valid sets of size-based factors. This is illustrated in the table below, which compares the results of allocating SJI's 2002 costs (net of the Prudential insurance de-mutualization of \$685,895³⁴) using a three-factor formula based on employees, revenues and operating expenses to one using SJI's chosen factors (assets, payroll and gross margin).

³² OC-2 (Section C-1) and 2001 support sent separately on January 23, 2003. According to management, six months of payroll data was used instead of twelve months to avoid skewing allocation results due to the significant redeployment of employees in November and December 2000 as a result of a work stoppage (SJG comments on draft report).

³³ Interview notes: Thomas Kavanaugh, January 14, 2003 (No. 11).

³⁴ OC-102.

Table 3-5 SJI Variation in Three-Factor Formula Results Using Different Factor Selections Using 2002 Data				
Cost Objective	Allocations Based on Assets, Payroll & Gross Margin	Calculated Allocations	Allocations Based on Employees, Revenues & Oper Expenses	Calculated Allocations
SJG	91.4%	\$ 934,700	78.6%	\$ 803,500
SJE	3.0%	30,338	12.4%	126,761
SJRG	2.3%	23,775	0.7%	7,156
SJI	1.5%	15,000	5.5%	56,225
ASB	1.5%	15,213	2.8%	28,623
Marina	0.3%	3,239	0.0%	-
	100.0%	\$ 1,022,265	100.0%	\$ 1,022,265
Notes 1. In determining entity headcount, SJI organization was adjusted to "assign" shared corporate services to SJI. 2. Company allocation factors in table are slightly different from intended factors documented in CAM. This is likely due to prior year corrections. 3. Company factors are based on a 6/30/01 cut-off. We employed 12/31/01 data since 6/30/01 data was not available.				
Primary Sources: OC-2, OC-11, OC-25, OC-79 and audit analysis				

The table shows that switching to a different set of well-recognized metrics and re-assigning the shared corporate service departments to the parent reduces SJG's corporate allocation by 14 percent and increases the allocation to non-regulated subsidiaries by 149 percent. This highlights not only the arbitrary nature of the methodology, but also its ability to serve a results-oriented strategy. In fact, the main appeal of a multi-factor allocation method is that its outcomes can be managed and it is defensible. It is defensible primarily because it is systematic. Its outcomes can be managed because nearly any grouping of factors with stable, predictable results can be used. It is not, however, an attributable cost allocation method.

Specific problems and issues involving the SJI three-factor formula include the following:

- a. The Historical Asset Factor - On June 30, 2001, SJG's net plant balance was \$567,920,231.³⁵ The SJI subsidiary with the largest asset balance besides SJG at that time was SJRG with a balance of \$30,558,330.³⁶ Obviously, the asset factor calculated by SJI was heavily influenced by SJG's plant balance. However, plant is an accumulation of costs incurred in prior years. It has little to do with most corporate activities conducted in the current year. As the oldest and, by far, the most capital

³⁵ OC-79.

³⁶ OC-2 (Section C-1).

intensive of SJI's subsidiaries, SJG has decades of accumulated plant costs. With the possible exception of functions such as plant and depreciation accounting, the corporate activities SJI conducts have little or nothing to do with the plant dollars SJG and other subsidiaries purchased or constructed in past decades.

- b. The Payroll Factor - As previously mentioned, SJG finally provided the support for its calculation of the 2002 three-factor formula the day before the draft report was due. As a result, we did not have time to determine the source or accuracy of the payroll amounts used in the company's calculations. However, it is quite likely that the "assignment" of shared corporate service functions to SJG had the effect of increasing the payroll reported for SJG and decreasing the payroll reported for SJI. This, in turn, would lead to an inappropriate upward bias in the payroll factor for SJG and downward bias in the payroll factor for SJI.
- c. The Gross Margin Factor - In adopting a three-factor formula to replace its asset-based factor from previous years, SJI / SJG management ignored the previous auditors' suggestion to incorporate operating revenues or operating expenses in the allocation of costs to "... more correctly reflect the amount of time required at the management and corporate levels."³⁷ SJI / SJG management concluded that the results of using such a factor would not be indicative of management effort and substituted gross margin in place of either of these two other measurements. One of the reasons given for this conclusion was that the other factors would push too many allocated dollars to SJRG.³⁸ While we not only find general fault with such a conclusion³⁹, it is inconsistent for management to dismiss one factor for not being indicative of management effort when the results do not conform to its expectations and to accept another factor when common sense suggests that the factor has little to do with cost causation (e.g., assets).

7. Allocation of Prudential Insurance De-Mutualization

In December of 2000, Prudential Insurance Company voted to reorganize from a mutual life insurance company (policyholders are the owners of the company, having membership interests in same) to a stock life insurance company owned by shareholders. In "de-mutualizing", policyholders are awarded equity interests in the new stock life insurance company. In 2002, SJI received \$914,527 for its equity interest in Prudential Financial, Inc. (Prudential). SJI

³⁷ Finding VI-3, p. 57.

³⁸ OC-2 (Section C-1, Exhibit A). This conclusion is somewhat mystifying given that SJRG (according to the consolidating income statements provided to us) only reported \$6,143,566 of operating revenues and \$1,515,959 of operating expenses in 2001 (OC-79). We used these reported figures in our recalculation of the three-factor formula. If we had "grossed up" the operating revenues and expenses of SJRG as suggested by the elimination entries, the results of the recalculation would have been significantly impacted.

³⁹ Given the intense media scrutiny of Enron and other energy trading firms, both the Board of Directors and executive management focused a great deal of time on risk management related to the SJRG wholesale gas business during 2002 (based on a review of the Board of Directors' minutes).

obtained this equity interest by virtue of the premiums it paid to Prudential for employee life insurance dating back to the late 1950's - early 1960's.⁴⁰

SJI determined that 75% of premiums were paid by the company and 25% were paid by employees. The proceeds allocated to employees (\$228,632) were put in a trust to provide current employees with a "premium holiday", estimated to last for approximately 32 months. The proceeds attributed to employer contributions were allocated by SJI to its subsidiaries using the three-factor formula.⁴¹

As can be seen in Table 3-4 above, costs and income (in this case) were allocated to six different cost objectives using the three-factor formula in 2002. Two of the six cost objectives did not exist prior to 1996 (SJRG and Marina), and two others were formed in the late 1960's - early 1970's (SJI and SJE).⁴² Although SJG was allocated the lion's share of costs as a result of employing the three-factor formula (91.4%), in this case, it is highly likely that nearly all of the income should have been allocated to SJG since it was the only entity in existence from the very first day of the relationship with Prudential, and it houses the vast majority of employees.

D. Shared Utility Functions

In addition to shared corporate services, SJG also provided certain services to its affiliates and competitive business segments that have historically been associated with the regulated utility operations. Some of the more significant services provided by SJG are discussed below.

1. Customer Service Costs

During the audit period, the ASB opened its own dedicated dispatch and customer call center in McKee City, New Jersey.⁴³ However, when customer calls could not get through to these dedicated employees, ASB customer calls "overflowed" to the SJG customer call center in Folsom, New Jersey.⁴⁴ SJG charged the ASB for providing this service based on the following formula (Total Number of ASB Calls X Fully Loaded Labor Rate X Average Length of Time per Call).⁴⁵ As will be noted in Chapter 4, since SJG was unable to provide support for its

⁴⁰ OC-102.

⁴¹ OC-102.

⁴² OC-16.

⁴³ OC-28 (Issue 9 - March 14, 2002).

⁴⁴ Interview notes: Robert Fatzinger, October 29, 2002 (No. 18).

⁴⁵ Interview notes: Bonnie Bornstein, October 30, 2002 (No. 16).

calculation of the average length of time per call, the appropriateness of the SJG charges to the ASB for these services cannot be determined.⁴⁶

In addition to handling some ASB customer calls, both the ASB and SJE relied upon SJG's customer service department to provide billing services during the audit period. These services (including billing, payment processing and general customer inquiries) were billed to all affiliated and non-affiliated customers at \$0.075 per bill.⁴⁷ According to SJG this rate has been in effect since August, 1997.⁴⁸ A review of the support provided by SJG for this rate indicates:

- C Information services hourly rates did not correspond with current rates.
- C Other rates (e.g., A/R balancing, printing reports and funds transfer fees) were not supported and likely do not represent the current cost of doing business.
- C Given the growth in SJG's service territory over the past five years, the number of billings used in calculating the rate is likely not accurate.

The Affiliate Standards require that the utility charge "no less than the fair market value" for services developed for sale on the open market to related competitive business segments of the public utility holding company.⁴⁹ Given that SJE was billed the same amount as third-party marketers, we believe that SJG complied with the intent of this standard.

Beginning in September, 2002, residential marketers will be charged \$0.30 per bill to reflect the additional service of purchasing receivables.⁵⁰ We were provided no support for the determination of this rate.

2. Service Department Labor Costs

At times during the audit period, SJG utility service technicians would perform appliance service repairs.⁵¹ The labor cost of service department personnel was allocated to the ASB based on job code information input into SJG's automated dispatching system (ADS). Each job code was

⁴⁶ SJG management represents that in December, 2002 and January, 2003, it reviewed the average call times for ASB inquires and found them to be between three and four minutes (SJG comments on draft report). However, support for this representation was not provided.

⁴⁷ Interview notes: Bonnie Bornstein, October 30, 2002 (Nos. 2 and 16) and OC-2 (Sections S-1 and S-2).

⁴⁸ OC-72.

⁴⁹ Affiliate Standards 14:4-5.5(t)1.

⁵⁰ OC-72.

⁵¹ Interview notes: Robert Fatzinger, October 29, 2002 (No. 8).

associated with a specific general ledger account.⁵² The ADS calculated total labor costs by multiplying the actual time spent on each job code by each employee's actual wage rate.⁵³

While allocating the labor cost of utility service technicians based on time input into the ADS is a proper method of attributing costs to the ASB, the accuracy of the charges from SJG to the ASB is heavily dependent on correct employee input into the ADS. We did not attempt to verify the accuracy of employee input into the ADS and to the extent that employees intentionally or unintentionally erred in inputting data, the resulting allocations may be incorrect, as is true with any system.

⁵² OC-2 (Section T-1).

⁵³ E-mail correspondence with Richard Walker, January 27, 2003.

Chapter 4 - South Jersey Gas Company Appliance Service Business

Chapter 4 - South Jersey Gas Company Appliance Service Business

I. Introduction

The South Jersey Gas Appliance Service Business (ASB) has provided appliance service repair and appliance service warranty contracts to customers in South Jersey Gas (SJG) Company's service territory for many years. These services are today classified as "competitive" and subject to the BPU's Affiliate Standards. Historically, appliance repair services were provided by utility service technicians with both utility and appliance service responsibilities. Beginning in 1998, SJG began to segregate the ASB from other SJG operations for financial reporting purposes. During the audit period, SJG began separating technicians into separate utility and appliance services. In 2002, the ASB opened its own dedicated dispatch and call center.

In 2002, SJG filed a petition with the BPU for authorization to transfer its ASB to a newly created subsidiary of its parent, South Jersey Industries, Inc. (SJI). As of the date of this report, this transfer has not been approved by the BPU or completed by SJG.

II. Summary of Audit Findings

A. Accounting Separation

During the audit period, SJG accounted for the ASB separately in SJG's general ledger and financial statement reporting package. However, some of the significant assets employed by the ASB (such as vehicles) were not segregated from the utility's assets on the general ledger.¹ In addition, the ASB did not track separately its dedicated expenses and fully allocated shared expenses as required by the Affiliate Standards.

B. Management Separation

The separation between appliance and utility management appears appropriate based on documented reporting relationships. At the end of the audit period, the director of the ASB reported directly to the President of SJG. There were no management employees directly responsible for appliance services who also had line responsibility for regulated gas utility operations.

C. Physical Separation

During the audit period, a majority of the ASB employees operated directly from their homes. Certain management employees, the ASB's dispatch and call center and the ASB's repair parts storeroom were located in facilities shared with the regulated utility. Short of requiring the ASB to purchase or lease its own dedicated facilities, we believe that the physical separation between the ASB and SJG is adequate.

¹ Interestingly, SJG was able to isolate these assets in its petition for authorization to transfer the ASB to a separate company.

D. Employee Separation

During the audit period, ASB employees consisted primarily of former employees of the regulated utility's Distribution Operations department. As such, they are capable of performing many routine and emergency "utility" services and do so at the request of customers while on ASB-related customer visits. The same is true of certain utility service technicians who have the ability to perform some appliance repair services. They are available to provide appliance services if requested. Although designed to meet the needs of customers, these actions cloud any distinction that the general public may make between the two businesses. As such, this is an example of poor separation between the utility and the ASB and should be prohibited in the future except in cases of emergency.

E. Shared Services

Neither SJG nor the ASB have an accounting system designed to track shared services separately from other expenses. A review of SJI's Cost Allocation Manual (CAM) indicates that allocations of shared services and other costs are based on a bottoms-up approach and are performed largely on a transaction-by-transaction basis. This, coupled with SJG's inability to provide useable electronic accounting detail, hindered our ability to analyze allocated costs. Further discussion of shared services and cost allocations, including the inappropriateness of using a three-factor formula to allocate costs, can be found in Chapter 3. In addition, SJG was unable to provide adequate support for its allocation of customer service costs to the ASB.

F. Use of Utility Customer Database

The ASB shares the utility's customer database. The ASB selectively screens utility data to develop targeted marketing programs to potential ASB customers. The utility does not charge the ASB for its use of customer data nor does it permit the ASB's competitors to have similar use of the data. The practice is at variance with the Affiliate Standards restrictions on sharing customer data.

G. ASB Floor Rates

Based on the premise that "floor prices" are the minimum prices that SJG is permitted to charge for its services and that they should reflect the fully allocated cost of the service, we independently calculated a fully allocated cost rate (using the ASB's own reported numbers) to determine whether SJG's calculated floor rates were reasonable. The results of this analysis indicated that SJG's current floor prices are significantly understated. However, floor prices will not apply once SJG transfers the ASB to a separate subsidiary of SJI.

H. Free Plan Program

During the audit period, new SJG gas-heat customers were offered free appliance service warranty plan heater coverage for the first year. By definition, since this complimentary service was offered below its fully allocated cost, it was cross-subsidized. Given the profitability of the ASB, the most likely source of cross-subsidization is other customers of the ASB rather than

SJG. Discounts such as these are common in the economy and do not necessarily represent anti-competitive behavior.

I. Competitive Advantage

The ASB's competitive advantages (compared with smaller independent appliance service companies) appear to outweigh its potential competitive disadvantages. Chief among the ASB's competitive advantages is its affiliation with the utility and the utility's brand. Other competitive advantages include economies of scale, access to the utility's billing envelope, access to an established customer service function (on an as-needed basis) and the use of a mature, reliable customer information system. These advantages may be partially offset by negative bias that some consumers may have toward SJG as a monopoly utility and by pricing constraints incorporated in the ASB tariffed rates. The cost advantage the ASB realizes from scale economies may be partially offset by its requirement to absorb certain corporate overhead costs, such as relatively high executive compensation, that smaller competitors do not incur, assuming that corporate overheads are fully and properly allocated.

J. Petition for Authorization to Transfer the ASB to a Separate Company

During the audit period, SJG filed a petition with the BPU for authorization to transfer its ASB to a subsidiary of SJG's parent company, SJI. More recently, SJG submitted a proposed stipulation relating to this petition.² From an accounting perspective, such a transfer should improve the separation of the ASB from the utility. We found that under the petition and stipulation, SJG appears to have established conditions that will permit appliance services to be performed by gas utility employees. Neither the petition nor stipulation address compensation for the going concern (economic) value of the business SJG proposes to transfer or the value of brand identity that the new subsidiary, which SJI proposes to name South Jersey Gas Service Plus, will derive from association with the utility and use of its name. We also note that the Affiliate Standards do not address compensation for going concern value or brand identity. Based on our analysis of the assets SJG proposes to transfer and lease, it appears that the BPU should consider whether SJG has provided enough information to permit the BPU to make an informed decision concerning the price of assets to be leased by SJG to the ASB. The BPU should also consider whether SJG and the new appliance subsidiary should be permitted to share technicians to perform non-emergency services. This practice appears to be at variance with Affiliate Standards restrictions for a competitive services segment owned by the holding company.

² Although requested from the company, we were not provided the exhibits to the proposed stipulation until mid-February, 2003.

III. Audit Analysis

A. Organization

During the audit period, the ASB operated as a separate business segment of SJG. As a result, the ASB is primarily subject to Section 14:4-5.6 of the Affiliate Standards which apply to related competitive business segments of a utility.³ At the time of the issuance of the ASB's 2002 Business Plan in August 2001, the ASB consisted of five full-time management employees, two parts clerks and 21 appliance service technicians (ASTs) for a total of 28 employees. On an as-needed basis, the ASB also had the use of 17 technicians from the regulated utility.⁴ In 2001, the ASB did not have its own dedicated customer call center⁵ or dispatching operations but rather relied upon SJG's regulated utility personnel to provide these services.

After the opening of its new, dedicated dispatch and call center in McKee City, New Jersey on March 11, 2002, the ASB organization consisted of five management employees, two order entry / parts clerks, 26 ASTs and six dispatch and call center representatives for a total of 39 employees.⁶ As was the case in 2001, on occasion, certain utility service technicians also provided appliance repair service for customers on an as-needed basis in 2002.⁷

B. Separation from Utility

1. Accounting Separation

The ASB maintains separate general ledger accounts on SJG's general ledger to track revenues and expenses of the business (A/C's 879.1 - 897.99).⁸ In addition, SJG reports the results of the ASB operations separately from its regulated utility operations in its monthly internal financial statement package.⁹

However, the ASB does not segregate all of the assets it uses in its normal course of business. In fact, other than inventories, computers, large tools, and possibly accounts receivable, all

³ On August 16, 2002, SJG petitioned the BPU for authorization to transfer its appliance service business to a newly created limited liability company, a subsidiary of SJG's parent -- South Jersey Industries, Inc. SJG proposed that this transfer be effective January 1, 2003. It is our understanding that as of the date of this report, this transfer had not yet taken place.

⁴ OC-32 (ASB 2002 Business Plan (dated 8/23/01)), p. 15.

⁵ Also commonly referred to as the Customer Care Center.

⁶ OC-28 (Issue 9 - March 14, 2002) and OC-13.

⁷ Interview notes: Robert Fatzinger, October 29, 2002 (No. 8).

⁸ Interview notes: David Kindlick, October 9, 2002 (No. 25) and OC-21.

⁹ OC-21.

assets used by the ASB, including vehicles, are commingled with utility assets. In addition, neither SJG nor the ASB can segregate directly assigned costs from shared services costs.¹⁰ Affiliate Standard 14:4-5.6 (n) specifically calls for the tracking of “dedicated assets, . . . dedicated expenses incurred in the start-up, promotion, and provision of service, . . . [and] fully allocated shared expenses.” These deficiencies are an indication that the ASB has not taken all the steps necessary to fully separate the ASB from SJG for accounting purposes.

Finally, while SJG provided an electronic version of its general ledger for the audit period, its format was such that data could not be easily extracted.¹¹ As a result, we were restricted in the analysis we could perform given the time constraints of the audit.

2. Corporate Governance and Management Separation

Prior to April 2001, the ASB reported through the utility organization as a separate appliance repair function of the Distribution Operations Department. With the hiring of Robert Fatzinger, Director of Appliance Service & Warranty Programs, the ASB was organizationally segregated from the regulated utility and no longer reported to the Assistant Vice President of Distribution Operations, but rather to Charles Bisciegia, SJG’s President. Mr. Fatzinger has no significant responsibilities associated with regulated utility operations.¹² We believe the management of the ASB was appropriately separated from the management of the regulated utility operations of SJG subsequent to the hiring of Mr. Fatzinger.

3. Office and Operating Facilities’ Separation

ASTs are home-based and, therefore, require no dedicated corporate space. In contrast, the ASB management team (five employees) is situated in various locations throughout the SJG service territory in SJG-owned facilities. Currently, the ASB maintains a storeroom for non-emergency ASB parts in the Glassboro Division. Prior to mid-2002, these were commingled with utility parts in various locations.¹³ As mentioned previously, a new dedicated ASB dispatch and customer call center was opened in McKee City, New Jersey in March of 2002. None of the space occupied by the ASB is for its exclusive use but rather shared with other SJG functions.¹⁴

A review of the accounting records during the audit period indicates that the ASB was being charged by SJG for the use of these identified facilities. However, in the case of McKee City, the limited information provided to us suggests that allocations of cost to the ASB were

¹⁰ Interview notes: Thomas Kavanaugh and David Robbins, January 10, 2003 (Nos. 10, 13, and 14)

¹¹ OC-40 and OC-44. SJG actually provided the data in 2 different formats -- one was the equivalent of a snapshot of the data in a word processing document and the other was in a spreadsheet format that was unnecessarily disorganized.

¹² OC-64.

¹³ Interview notes, Robert Fatzinger, October 29, 2002 (No. 4).

¹⁴ OC-39.

understated. If requested information had been provided, a more thorough analysis would have been possible. See Chapter 3 for further discussion.

The relatively small number of ASB employees currently using common facilities does not appear to present a serious problem with respect to the commingling of utility and appliance operations.

4. Asset Separation

- a. Physical Assets - The primary physical assets employed by the ASB are vehicles, repair parts inventory and the automated dispatching system (ADS). As mentioned previously, the non-emergency repair parts inventory is currently centralized in one location and no longer commingled with utility inventory. Vehicles are assigned to specific home-based ASTs. Since much of the ADS equipment is physically located in the vehicles, it is our opinion that the ASB has adequately segregated its non-shared assets on a physical basis.
- b. Information and Information Systems - The ASB uses the same customer accounts system as SJG's regulated utility operations and has access to the same customer account screens.¹⁵

5. Appliance Service and Utility Employee Separation

The ASB organization has evolved over the years. Primarily composed of former utility service technicians with specialized skills, its workforce was segregated from the regulated utility so that it could focus primarily on appliance work.¹⁶ However, given their previous work experience, ASTs are trained to perform both routine and emergency utility services and are called upon to provide these services on an as-needed basis. In addition, ASTs responding to ASB customer calls perform utility work at the customer's request when on-site. ASB management indicated that it does not expect this approach to change even if the ASB is transferred to a separate entity.¹⁷

Likewise, certain utility service technicians are capable of performing some appliance repair work. These employees are occasionally called upon to assist the ASB during peak work periods and also will perform appliance repair services on "utility work" calls if requested by the customer. In all cases, management represents that the appropriate business is charged for the actual work performed.¹⁸

¹⁵ Interview notes: Bonnie Bornstein, October 30, 2002 (No. 18); Bonnie Bornstein, November 1, 2002 (No. 2); and Patrick Finnigan, October 30, 2002 (No. 16).

¹⁶ OC-32 (ASB 2002 Business Plan (dated 8/23/01)), p. 3.

¹⁷ Interview notes, Robert Fatzinger, October 29, 2002 (No. 48) and OC-32 (ASB 2002 Business Plan (dated 8/23/01)), p. 3.

¹⁸ Interview notes, Robert Fatzinger, October 29, 2002 (Nos. 8 and 35).

While the willingness of the ASTs and utility service technicians to perform both types of services (especially during the same service call) receives high marks for customer-focused service, in the context of competitive business segment separation, this approach is less than desirable. Any distinction that the general public may make between SJG, the regulated utility, and the ASB is clouded when employees of either organization perform both types of service. At least one utility in the state of New Jersey has a policy of only allowing ASTs to perform utility services when a “make safe” situation is confronted during a customer call. We believe that this alternative (especially when the ASB is transferred to a separate legal entity) is the only approach that guarantees the proper separation of utility and appliance businesses.

Although SJG currently has a proposal in its petition to transfer the ASB to a separate company discussing the work that it will continue to perform for the ASB, its proposal is ambiguous. Further discussion concerning this proposal and other implications of the petition occurs later in this chapter.

C. Centralized Services and Shared Services

The ASB relies upon both SJG and, to a lesser extent, SJI to provide many of its administrative functions. These functions include, but are not limited to, human resources, accounting, information systems, billing, marketing and risk management.

As discussed in Chapter 3, SJG employs a cost allocation process that is:

- C Premised on a bottoms-up rather than a top-down approach,
- C Performed largely on a manual, transaction-by-transaction basis,
- C Billed in such a manner as to limit the ability to ascertain the sources of inter- and intra-company charges.

These factors, coupled with SJG’s decision not to adopt departmental / responsibility center accounting and its inability to provide us with useable electronic accounting data, prevented us from performing a thorough analysis of the ASB’s allocations of SJG’s and SJI’s shared services costs. The limitations of SJG’s and its affiliates’ cost allocation systems is best evidenced by SJG’s inability to summarize the total shared services costs incurred by major function and the distribution of these costs to the various affiliates.¹⁹

SJG (through its parent, SJI) allocates a significant amount of corporate shared services costs by employing a “three-factor formula”. During the audit period, the ASB was charged only \$15,213 for costs allocated in this manner, partly because the ASB was not a cost objective of these costs in 2001.²⁰ Chapter 3 discusses SJI’s and SJG’s use of the “three-factor formula”.

¹⁹ OC-137.

²⁰ OC-11 and interview notes: Thomas Kavanaugh and David Robbins, January 10, 2003 (No. 17).

In addition to these global deficiencies with SJG's allocation process, the following shared services allocation relating specifically to the ASB is discussed below.

1. Allocation of Customer Service Costs

Prior to the opening of the dedicated ASB Customer Call Center in McKee City, New Jersey, SJG's regulated utility call center (located on the second floor of the Corporate Headquarters in Folsom, New Jersey) handled all ASB customer calls.²¹ Currently, the Folsom call center only handles the overflow volume of the ASB call center.²² According to SJG, all calls received in Folsom are categorized by type of call by the customer service representatives (e.g., ASB Scheduling, ASB Billing, etc.). After the system accumulates the total number of calls per category, an allocation of customer service costs to the ASB is calculated as follows²³:

$$\begin{array}{r}
 \text{Total Number of ASB Calls} \\
 \times \text{Fully Loaded Labor Rate} \\
 \hline
 \times \text{Average Length of Time per Call} \\
 \hline
 \text{Allocated ASB Costs}
 \end{array}$$

SJG was unable to produce support for the third factor of the equation above (average length of time per call). In total, the costs allocated to the ASB from the Folsom Customer Call Center in 2001 and the first nine months of 2002 were \$126,720 and \$85,527, respectively.²⁴ SJG should be able to support the factors used in allocating costs to the ASB. We recommend that SJG either program its call system to monitor actual time spent on calls per category or, in the alternative, perform a current time study.

D. Business Development, Marketing, Advertising and Sales

1. Joint Marketing Services

The ASB's marketing function is a joint effort of Robert Fatzinger, Director of Appliance Service & Warranty Programs and SJI's Market Planning & Forecasting Department, headed by Joseph Scheufele. In addition to supporting the ASB's marketing efforts, Mr. Scheufele's department also supports the sales forces of SJI, SJG and South Jersey Energy Company (SJE).²⁵ We

²¹ Interview notes, Bonnie Bornstein, October 30, 2002 (No. 10).

²² Interview notes, Robert Fatzinger, October 29, 2002 (No. 18).

²³ Interview notes, Bonnie Bornstein, October 30, 2002 (No. 16).

²⁴ OC-11 and OC-40.

²⁵ OC-28 (Issue 2, April 4, 2001)

identified the following key interactions between the regulated utility operations of SJG and the ASB:

- C Use of utility bill inserts and envelope flap as an advertising device.²⁶
- C Use of utility customer database for target marketing purposes.²⁷
- C Offering of free plan program for new gas heating customers.²⁸
- C Association with SJG through corporate brand and logo (see below).

2. Use of Utility Customer Database

SJG permits the ASB to use its customer database free of charge for target marketing purposes without offering the same opportunity to unaffiliated appliance service competitors of the ASB.²⁹ As an example, Mr. Scheufele determined that homeowners who participated in the gas utility's equal payment plan (EPP) were both more likely to purchase other utility programs and plans and more likely to pay their bills on time. Based on this premise, the ASB divided the gas utility customers into two separate groups (those who participated in the EPP and those who did not) and used this information to craft individual targeted marketing promotions to each group. In the first three months of 2002, this targeted marketing resulted in the addition of over 1,500 new ASB customers.³⁰

The Affiliate Standards preclude a gas utility from assisting in the marketing or business development of a public utility holding company (PUHC), a competitive business segment of a PUHC, or a competitive business segment of a gas utility unless this assistance is provided to competitors on a non-discriminatory basis.³¹ If Mr. Fatzinger (an SJG employee) obtained the confidential customer data for the ASB's use, this would constitute a violation of the Affiliate Standards. If on the other hand, Mr. Scheufele (an SJI employee) obtained the data without any assistance from an SJG employee, the Affiliate Standards could be narrowly interpreted to suggest that no violation of the Affiliate Standards occurred. We do not know whether the BPU intended this loophole. Notwithstanding the possible SJI loophole, it appears highly unlikely that Mr. Scheufele and his department mined SJG's databases manually without any assistance from SJG's Information Services Department or its Customer Care (Services) Department. If

²⁶ OC-32 (ASB 2002 Business Plan (dated 8/23/01)), p. 10.

²⁷ OC-28 (Issue 12, May 14, 2002), OC-107, and interview notes, Joseph Scheufele, November 22, 2002.

²⁸ OC-32 (ASB 2002 Business Plan (dated 8/23/01)), pp. 10-11. This program provides free Service Sentry heater coverage for the first year.

²⁹ OC-107.

³⁰ OC-28 (Issue 12, May 14, 2002).

³¹ Affiliate Standards 14:4-5.3(m) and 14:4-5.6(m).

anyone from SJG assisted Mr. Scheufele in obtaining this data, these actions would also constitute a violation of the Affiliate Standards.

3. Utility and Corporate Brand Association

Since it is part of SJG (and not an affiliate), the ASB is permitted to use the gas utility's name in promoting its competitive services. During the audit period, the ASB promoted its brand in a variety of ways -- including several in which its affiliation with SJG is prominent. This is illustrated as follows:



In addition to references concerning the "South Jersey Gas Repair Team", the ASB also promoted itself under the "Service Sentry" name during the audit period.³² This name was generally used in association with the different appliance repair warranty programs offered by the ASB.

When the ASB is transferred to a separate legal entity, the ASB intends to adopt the corporate logo shown below and to refer to itself as "South Jersey Gas Service Plus".³³



³² OC-36 and a review of the then current SJG internet site.

³³ OC-106.

SJI and its primary subsidiaries (SJG, SJE, and the ASB) will use the flame logo shown above to emphasize their common ownership.

E. Appliance Service Profitability, Pricing and Cross-Subsidization

One of the key audit objectives in the BPU's Request for Proposal is to determine whether competitive services are cross-subsidized by utility services. The basis for evaluating cross-subsidization is discussed in Chapter 2. Our analysis of appliance service costs and prices determined the following:

- SJG and SJI did not properly allocate all shared services costs to the ASB in 2001 and 2002. Among the costs we believe have been under-allocated or mis-allocated to the ASB are the following:
 - "Management service fee" and "corporate and fiscal" costs allocated using a three-factor formula rather than an attributable cost methodology.
 - Customer service costs charged to the ASB based on unsupported average call times (discussed above).
 - Possibly costs associated with the McKee City, New Jersey facility.
- The ASB's "floor price" calculations for appliance services were flawed and did not properly reflect fully allocated costs. At least on an overall basis, the calculations understated fully allocated costs because they did not include a full complement of direct operating costs or shared services costs attributable to the ASB and because they did not properly account for the non-productive time of its employees in determining an appropriate hourly rate.
- The ASB's "free plan program" was offered at a price below the fully allocated cost of the service and, consequently, were either cross-subsidized by SJG / SJI or, more likely, from other services offered by the ASB.

1. Financial Results

The following table summarizes the financial results of the ASB for the year ended December 31, 2001 and the nine months ended September 30, 2002:

SJG asserts that the following table includes confidential information.

Table 4-1 Appliance Service Business Summary of Financial Results		
	12 Months Ended 12/31/01	9 Months Ended 9/30/02
Revenue:		
Service Plans	Redacted	Redacted
Time & Materials	Redacted	Redacted
Other	Redacted	Redacted
Total Revenue	Redacted	Redacted
Direct Expenses:		
Service Plans	Redacted	Redacted
Time & Materials	Redacted	Redacted
Other	Redacted	Redacted
Total Direct Expenses	Redacted	Redacted
Administrative Expenses	Redacted	Redacted
Total Operating Costs	Redacted	Redacted
Income Before Taxes	Redacted	Redacted
Pre-Tax Income as a % of Revenues	Redacted	Redacted
Source: Derived from OC-21		

At first glance, a review of this data indicates that the ASB was pricing its services in a manner to recover its identified costs. Included in the ASB's costs are some allocations of shared corporate and utility costs. However, we were unable to obtain sufficient support for many of these costs to determine that the ASB is recording a proper share of these costs. To the extent cost allocations are not grossly understated (something that appears unlikely but cannot be ruled out), the ASB's profit margin indicates that its prices are probably sufficient to cover its fully allocated costs. Thus, under an assumption that unauditable cost allocations are not grossly understated, the ASB *prices* are high enough so that they are not cross-subsidized. However, to the extent that SJG or SJI allocated shared costs to SJG that should have been allocated to the ASB, SJG has cross-subsidized certain ASB *costs*.

2. ASB Pricing

To determine the reasonableness of ASB pricing, we compared an audit estimate of the fully allocated cost of the ASB (excluding parts expense) to the prices included in the ASB's "floor price" analysis (used to justify tariffed appliance service prices) and to hourly prices in the appliance service tariff itself.

- a. Audit Estimate of Fully Allocated Hourly Appliance Service Cost - Our audit estimate of fully allocated cost per hour, summarized in the following table, is derived from the financial results above. Mis-allocations of shared services costs by the company may skew the results one way or the other, but the computation should provide an overall test of reasonableness of the Company's previous calculations.

SJG asserts that the following table includes confidential information.

Table 4-2 Appliance Service Business Audit Calculation of Fully Allocated Cost Per Appliance Service Technician Hour		
	12 Months Ended 12/31/01	9 Months Ended 9/30/02
Total Operating Expenses (per Financial Summary above)	Redacted	Redacted
Less: Repair Parts Expense	Redacted	Redacted
Total Operating Expenses less Repair Parts Expense	Redacted	Redacted
FDC Cost Factors:		
Average number of ASTs	Redacted	Redacted
Estimated average number of weeks on the job per employee	Redacted	Redacted
Actual days per week	Redacted	Redacted
Estimated productive (on-site, non-drive, non-break) hours per day per employee	Redacted	Redacted
Estimated annual revenue-generating service hours, (employees x weeks x days x productive hours / day)	Redacted	Redacted
Est avg allocated cost per productive AST service hour without parts	Redacted	Redacted
Est avg allocated cost per productive AST service hour with parts	Redacted	Redacted
Sources:		
Repair parts expense: OC-140		
Average number of ASTs: OC-139		
Estimated average number of weeks on the job per employee - assumed an average of 2 weeks of holidays and 2 weeks of vacation per year.		
Estimated productive hours per day per employee - based on a review of September 2001 and December 2002 productive vs. non-productive time per the Monthly Summary Report by Division (OC-65)		

- b. SJG's Floor Price Calculations - It is our understanding that "floor prices" are the minimum prices that SJG is permitted to charge for appliance services and that they should reflect the "fully allocated cost" of providing the services. We obtained and reviewed SJG's support for its ASB floor price calculations. The ASB offers its services in three primary formats: time and material, flat rate, and warranty programs. The floor pricing of each of these services is based upon the hourly labor rate of \$85.36/hour requested by the company and approved by the BPU in Docket No. GR99010022.³⁴ As demonstrated in the preceding table, the Company's floor prices do not account for the fully allocated cost of its business. This is likely due to the following:
- No apparent adjustment for non-productive time in calculating available AST hours (both for vacation and holiday as well as general down-time while on the job).
 - Price inflation between 1998/1999 and 2001/2002.
 - The Company's reliance on an allocation methodology that fails to fully allocate attributable costs.
- c. Tariffed Prices - Notwithstanding SJG's and SJI's failure to fully allocate costs, the ASB's tariffed prices were high enough to produce recorded pre-tax profits. The following table shows a selected comparison of the ASB's calculated floor rate, its tariffed price and the calculated percentage mark-up on several different services:

Table 4-3 Appliance Service Business Selected Comparison of Floor Rates and Tariffed Prices				
Rate Schedule	Description	Floor Rate	Tariffed Price	% Mark-Up
ARS	Time & Materials – Competitive	\$ 85.36	\$ 128.04	50.00%
ARS-SS	Water Heater	9.23	22.80	147.02%
ARS-SS	Natural Gas House Heater	41.03	72.00	75.48%
ARS-SS	Electric Central Air Conditioner	42.89	114.00	165.80%
ARS-SS	Natural Gas Range	20.89	45.00	115.41%
ARS-SS	Natural Gas Dryer	15.15	39.00	157.43%
ARS-SS	Pipe Care	6.20	16.98	173.87%
ARS-FR	Belt-Dryer, Maytag (311012)*	82.55	121.00	46.58%
ARS-FR	Ignitor HIS / 41-406*	100.51	146.00	45.26%
ARS-FR	Thermostat, T-8700*	144.46	209.00	44.68%
* Normal business hours				
Source: South Jersey Gas Company Tariff - Appendix B (obtained from internet site)				

³⁴ OC-68 (Exhibit B). Hourly rate is applicable during normal business hours.

Note that our recalculated average rate for time and materials of approximately \$115 per hour (without parts) is only slightly less than the price the ASB charges for these services. However, given that the ASB earns most of its revenues on Service Sentry products (Rate Schedule ARS-SS in the table above), its generous mark-up on these services allows it to more than offset any prices set near its true fully allocated costs. In this respect, the tariffed prices for the ASB are set high enough (on paper) to avoid cross-subsidization.

- d. Free Plan Program – According to SJG, this program “. . . provides new SJG gas-heat customers with free Service Sentry plan heater coverage for the first year . . . [and has] experienced a 60% renewal rate since inception.”³⁵ The renewal rate is not surprising considering that the terms and conditions of SJG’s Service Sentry plans indicate that the plans automatically renew upon the contracts’ expiration unless the customer explicitly notifies the Company in writing.³⁶ According to management, the ASB has gained over 18,000 customers during 2001 and the first ten months of 2002 through this program.³⁷

Given the profitability of the ASB during the audit period, it is likely that the Free Plan Program reflects a short term cross-subsidy of new customers by other ASB customers (an intra-entity cross-subsidy). However, since the service contracts are likely attached to new appliances, in the long run, these customers should more than make up for their first “free” year with contract payments exceeding the ASB’s maintenance costs in subsequent years, assuming a sufficient percentage of them continue to remain customers after the first year.³⁸ Such discounts are common throughout the economy and are not considered to be anti-competitive.

Interestingly, while SJG’s tariff contains language that “. . . the Company may not charge less than the Floor Rates set forth in the Floor Rates section of this Rate Schedule . . .”³⁹ for both time and materials work and flat rate work, comparable language is non-existent for the rate schedule of the Service Sentry program.

³⁵ OC-32 (ASB 2002 Business Plan (dated 8/23/01)), p. 11.

³⁶ OC-66.

³⁷ OC-67. It appears that the ASB is offering this service to more than just first-time gas-heat customers. SJG said that in 2002 “. . . 15,046 customers renewed or upgraded their coverage through this [Free Plan] program through October.” However, SJG only added 15,170 total customers to its system in all of 2001 and 2002 combined. (Source: 2001 data - 6,804 customers: from hand-out from Executive Management on October 31, 2002. 2002 data - 8,366 customers: from SJI news release dated January 28, 2003). These figures coupled with a 60% renewal rate for the program do not appear to support the rapid growth of the Free Rate Program. One likely explanation is that it is being granted to a larger customer base than originally intended.

³⁸ An accurate quantification of the cross-subsidy would require data concerning the incident rates of new SJG gas-heat customers that we do not have. However, we believe that new gas-heat customers are likely to have lower incident rates than the general population. As a result, the cost of providing this service should be more than made up in subsequent years.

³⁹ South Jersey Gas Company Tariff (Appendix B).

F. Analysis of Competitive Market Advantages and Disadvantages Associated with Utility Affiliation

A detailed study of the market for appliance services in SJG's service territory and the ASB's share of that market was not within the scope of the audit. However, review of the ASB and its operations permits the following analysis of the competitive advantages and disadvantages conferred on the ASB relative to appliance service competitors not affiliated with the utility. Although not subject to direct quantification, we believe the available competitive advantages of ASB's affiliation with SJG and SJI outweigh any disadvantages.

1. Competitive Advantages

- a. Utility brand affiliation - The ASB's association with the gas utility, directly promoted through advertising, provides it with a clear competitive advantage over smaller, lesser-known appliance service providers. Management clearly recognizes this as evidenced by the following:
- Identification of the "SJG brand name" and "trust in the 'local utility' to stand behind workmanship" as the first two strengths listed in the ASB's 2002 Business Plan⁴⁰;
 - Marketing strategy to "promote and trade off brand of SJG"⁴¹;
 - Acknowledgment that "... the strongest customer and key public connections / recognition is with South Jersey Gas Company, ... [and] a near-term goal for senior management is to position these brands [SJG, SJE, and SJI] so that key public see them as one and the same."⁴²; and
 - The ASB's decision to adopt the corporate logo used collectively by SJG, SJI and SJE and to include in its name its "South Jersey Gas" affiliation (see logo above).

Association with the utility is likely to inspire a higher degree of customer trust in the ASB and the employees it sends into customers' homes. Apart from the higher level of trust that utility association inspires, the utility name itself has name recognition value. It is not unreasonable to expect that nearly all adults living in the SJG service territory recognize the gas utility's name. The same cannot be said for smaller competitors participating in the appliance service repair market. In its petition, the ASB has not proposed to compensate the regulated utility for the advantage conferred by brand association. To the extent

⁴⁰ OC-32 (ASB 2002 Business Plan (dated 8/23/01)), p. 11. Requests for more recent strategic and business plan materials were either denied or ignored by the company (see Company's response to OC-86 and its unwillingness to answer OC-123 after nearly 2-1/2 months have elapsed.)

⁴¹ OC-32 (ASB 2002 Business Plan (dated 8/23/01)), p. 13.

⁴² OC-32 (SJI Strategic Planning Report (dated March 2000)), p. F-1.

brand association has an economic value to the ASB, it is not currently reflected in tariff prices.

- b. Economies of Scale - The size of SJG's service territory, encompassing several hundred thousand potential customers, provides it the ability to extract economies of scale that competitors with smaller geographic footprints cannot attain.
- c. Access to the utility's billing envelope - During the audit period, the ASB used the utility's billing envelope as one of its primary advertising tools. The ASB's exclusive access to the utility's billing envelope provides a significant competitive advantage in reaching potential customers. The cost per potential customer of inserting appliance service advertising into utility billing envelopes is minimal.⁴³ Beginning with the postage, the costs smaller competitors would face to attain the same household reach are much higher and potentially prohibitive.
- d. Access to the utility's customer service function and information system - The ability to tap into a fully staffed utility customer care function (when customer call volume is extremely high) and an established customer service information system is also a competitive advantage. When gas appliance owners have problems with heat (either with their furnace or hot water heater), they may make the gas utility their first call. When they do, SJG's call system presents a series of menu options -- one of which is the ASB. Competitors enjoy no such presentation on the call system's list of options. With respect to the cost of conducting customer operations, although the ASB has its own customer call center and pays for any overflow to the utility's customer call center (as previously noted, the cost for this utility service was not adequately supported), it did not have to pay for most of the costs of developing the customer service information system.⁴⁴ For several reasons, including a lack of scale economies, a smaller competitor would in most cases find a similar customer service function to be either more expensive, if not unaffordable. Even to the extent it could be afforded, it would not be as valuable to competitors as it is to the ASB because the link between the regulated utility and the ASB established by the call system would not exist.

⁴³ The costs amount to some marketing labor or third party vendor services to develop the promotional material, some printing costs and possibly some incremental postage, but only to the extent that the addition of the appliance services advertising increases the postage over what it would have been without the advertising.

⁴⁴ As a new separate business unit beginning in 1998, the ASB was able to piggyback onto a highly-developed customer service function and information system. In an interview with Patrick Finningan on December 19, 2002, Mr. Finningan said that modifications and improvements to the legacy mainframe system in the past were generally not capitalized. Therefore, any expense associated with these modifications and improvements has long been recognized by the utility and possibly other existing entities.

2. Competitive Disadvantages

- a. Utility Affiliation - There are individuals who resent utilities because of their monopoly status or because they have had bad experiences with the utility company. For these individuals, the ASB's affiliation with the utility could represent a competitive disadvantage. However, the ASB's use of the SJG name and its intent to jettison its previous logo for one that is closely identified with SJG and its other affiliates to advertise appliance repair services clearly demonstrates management's belief that the advantages of being associated with the utility name outweigh any disadvantages.
- b. Tariffed Rates - The ASB is currently required to file tariffed rates and to avoid cross-subsidies by maintaining rates at or above the "fully allocated cost" of providing service. Competitors are not bound by this restriction. However, we found that in some cases (namely the Free Plan Program) that the ASB did not maintain appliance service prices sufficient to recover fully allocated costs. As such, during the audit period the tariff and pricing restrictions imposed on the ASB were at times primarily a theoretical, rather than an actual, competitive disadvantage.
- c. Corporate Overheads - The ASB is required by Affiliate Standards to incur corporate administrative expenses that smaller competitors may not incur. For example, smaller competitors are unlikely to incur costs similar to those incurred by SJG's and/or SJI's executive, treasury, investor relations and legal functions that are charged to the ASB. However, although Affiliate Standards require that these costs must be recorded on ASB's financial records, they do not affect profitability *per se* except to the extent they are incremental to the provision of appliance services.⁴⁵ In addition, we found that the allocation procedures did not provide for allocations of all costs attributable to the ASB.

IV. SJG Petition for Authorization to Transfer its ASB to a Newly Created Company

On August 16, 2002, SJG filed a petition with the BPU for authorization to transfer its ASB to a newly created company. This company (in the form of a limited liability company) would be a subsidiary of SJG's parent company, SJI. SJG proposed that this transfer be effective as of January 1, 2003.

Subsequent to this petition (December 20, 2002), SJG submitted a proposed stipulation to the BPU which, among other things, established the formal name of the newly created company as South Jersey Gas Service Plus and conditioned the approval of the transfer of ASB on the Final Order of Approval of the Board resulting from the Affiliate Standards audit.

⁴⁵ In other words, the true economic disadvantage imposed by these costs is limited to their incremental impact on SJI's corporate profits. This impact is limited to the 1) additional corporate costs that providing appliance repair services imposes on SJI, and 2) non-incremental corporate costs that are allocated to the ASB that would otherwise be charged to regulated utility operations and recovered from gas utility customers in regulated rates.

To our knowledge, neither the petition nor the proposed stipulation have been acted upon by all necessary parties as of the writing of this report. Since we were only recently provided the exhibits associated with the proposed stipulation, we have not had time to compare and contrast the petition and the proposed stipulation.⁴⁶ As a result, any substantive changes made by SJG to the exhibits that are not referenced in the language of the proposed stipulation may go unnoticed. We made the following observations concerning the documents that were provided to us in a timely manner.

A. Transfer and Lease of Assets

Whether intentional or not, the Affiliate Standards have two slightly different requirements for transfers of assets between utilities and competitive business segments depending on whether the competitive business segment is part of the utility or not. The pricing provisions concerning the transfer of utility assets between a utility and its PUHC or a competitive business segment of the PUHC call for the transfer to “. . . be recorded at fair market value or book value as determined by the Board.”⁴⁷ On the other hand, transfers of utility assets between a utility and a competitive business segment of the utility, “. . . for purposes of the asset becoming a dedicated asset of the related competitive business segment of the public utility, shall be recorded at the greater of book cost or fair market value and shall be subject to approval by the Board.”⁴⁸

Based on a review of the exhibits of the petition, it appears that the transfer of assets between SJG and the ASB will take place after the newly formed company has been created. As such, the first standard applies and the BPU will determine at which price the assets will be transferred.

Under the current terms of the petition and the proposed stipulation, the net book value of the assets SJG proposes to lease to the ASB significantly exceeds the net book value of the assets it intends to sell to the ASB (\$1,388,430 vs. \$620,056).⁴⁹ However, SJG does not know what it would cost to lease similar assets from third parties.⁵⁰ If the BPU determines that it is appropriate for SJG to lease rather than to sell its vehicles outright to the ASB, it should require SJG to determine the fair market value of such leases so that it can make an informed decision on how these transactions should be priced.

⁴⁶ We requested this information by e-mail from SJG's Corporate Secretary & Corporate Counsel on January 6, 2003. We were provided a copy of the exhibits mid-February 2003.

⁴⁷ Affiliate Standard 14:4-5.5 (u).

⁴⁸ Affiliate Standard 14:4-5.6 (q).

⁴⁹ OC-70.

⁵⁰ Interview notes: Robert Fatzinger, October 29, 2002 (No. 53).

Additionally, compensation for the transfer of ASB's accounts receivable (asset) and deferred warranty service revenues (liabilities) to the newly created company was not addressed in the petition. In September of 2002, the balance of these two items netted to \$1,167,028.⁵¹

B. Permitted Service Repairs

The original petition is somewhat confusing in that it states “. . . South Jersey will no longer provide non-safety related and non-emergency related appliance repair services.” (p. 5) Yet, in Exhibit D to the same petition, SJG sets up a mechanism in which the newly created ASB entity “. . . may call upon [SJG] to provide [SJG] employees and associated equipment. If these employees and equipment are available, [SJG] shall supply them to [the newly created ASB entity]. These services shall include, but not be limited to: water heater repairs; house heater repairs; and house heater preventative maintenance.”⁵² Perhaps the intent of the petition was to make a distinction between what services the utility (in its normal course of business) would pursue with its own customers and what services it was prepared to offer on behalf of the ASB if specifically requested. Nevertheless, the ASB obtains a competitive advantage from such an arrangement because 1) it never has to share the utility technicians' services with competitors (e.g., net income generated from utility technicians providing appliance repair services are not distributed among ASB and its competitors; they only are passed onto the ASB and 2) it reinforces the perception that the utility and the ASB are one and the same. For purposes of separation, we believe that it would be preferable to prohibit utility employees from providing ASB services if and when the transfer is completed.

C. Going Concern Value of the ASB

The ASB customer list and associated cash flows, built up by the gas utility over a number of years, reflects the essential going concern (economic) value of the utility's appliance services business. If SJG were to sell the business to an unaffiliated third party, it would expect to receive compensation for this value. Value would be measured on a discounted cash flow basis and would probably be in the millions.⁵³ The petition to transfer the ASB to a newly created company does not appear to address the ASB's service contract customer list and associated cash flows or any compensation related to value.

We did not include going concern value in drawing conclusions about cross-subsidization. It is within reason to argue that the lack of compensation for transferring the value of a business would amount to a significant economic cross-subsidy. However, it is equally important to point out that there is nothing in the BPU's Affiliate Standards that requires holding companies or their competitive services affiliates to compensate utilities for the transfer of competitive services going concern.

⁵¹ Derived from OC-40.

⁵² Exhibit D of Petition dated August 16, 2002 , p. 1.

⁵³ However, it is important to point out that the value to a third party would be significantly lower if it excluded an ongoing partnership or affiliation with the utility and use of associated brands.

Although not required by the BPU's Affiliate Standards, when New Jersey Natural Gas transferred its appliance services business to a new parent company subsidiary approximately two years ago, it received a portion of the appliance services business' margin for several years as compensation for the pre-tax margins generated from the existing services. However, it is unclear whether the compensation paid to New Jersey Natural Gas approximated the going concern value of the appliance services business.

D. Value of Brand Name

SJG has identified its brand as a major asset. In 2000, SJG retained Star Group to develop and design a new logo which would, according to Charles Bisciegia, SJG President, "... establish a single identity that transfers to each company [SJG, SJI, and SJE]."⁵⁴ The ASB now intends to adopt the same logo and refer to itself as South Jersey Gas Service Plus. Based on a review of the petition, it does not appear that the ASB plans on compensating SJG for use of this brand. Nothing in the Affiliate Standards requires such compensation. The BPU should consider whether this intangible asset warrants recognition as an affiliate transaction and, if so, how much the ASB and South Jersey Energy, SJI's other major competitive services segment, should pay for its use.

⁵⁴ OC-28 (Issue 3, 5/5/00).

Chapter 5- Millennium Account Services

Chapter 5- Millennium Account Services LLC

I. Introduction

This chapter addresses Millennium Account Services LLC (Millennium). Millennium is a joint venture between South Jersey Industries, Inc. (SJI) and Conectiv Solutions LLC (Conectiv). Millennium's primary service is meter reading. During the audit period, Millennium's 83 employees provided meter reading exclusively to the utility affiliates of SJI and Conectiv.

II. Summary of Audit Findings

A. Applicability of Affiliate Standards to Millennium

It is our understanding that the New Jersey Board of Public Utilities' (BPU's) staff has determined that the meter reading function falls within the definition of a competitive service. Similar services such as metering and billing are deemed competitive services by the BPU.¹ According to the Affiliate Standards, the "offering [of] competitive services to retail customers in New Jersey"² falls within the scope of the standards. Millennium limits its services to the New Jersey service territories of South Jersey Gas Company (SJG) and Conectiv Power Delivery, and neither of these two customers re-sells the meter reading services provided by Millennium to their own customers. For these reasons, we have interpreted the Affiliate Standards as applicable to Millennium. In considering whether Affiliate Standards apply to Millennium, the BPU should take notice that Millennium is charging SJG based on transfer prices that appear to exceed both its fully allocated cost of service as well as a market-comparable price evidenced by meter reading bids submitted to SJG by two other companies.

B. Separation of Accounting, Physical Assets, and Employees from SJG

Separations of accounting, physical assets, and employees between Millennium and SJG are sufficient to prevent commingling of direct operations.

C. Management Separation

The Executive Committee of Millennium is comprised of two members of SJG's executive management team. This arrangement does not provide strict separation between Millennium and SJG's executive management.

D. Access to SJG Information Systems

Millennium employees enter premise numbers into SJG's customer information system as an ancillary service. Millennium employees have "read" access to a wide spectrum of confidential customer information, including whether or not customers have opted to purchase appliance repair services from the utility and whether they purchase gas commodity from gas marketers.

¹ Affiliate Standards 14:4-5.6(b)1.

² Affiliate Standards 14:4-5.1(a)1.

Management believes the confidentiality agreement between Millennium and SJG protects SJG's interests.

E. Marketing and Promotion

It does not appear that Millennium cross-marketed services or participated in joint promotions with SJG during the audit period.

F. Cross-Subsidization of Millennium By SJG

Affiliate Standards limit the price Millennium is permitted to charge SJG to the lower of fully allocated cost or market. Millennium's prices exceeded both fully allocated cost as well as "market-comparable" prices evidenced in bids submitted by two other companies. Analysis indicates that fully-allocated cost was the maximum price Millennium was permitted to charge SJG under Affiliate Standards. Based on the amounts by which Millennium's prices exceeded fully allocated cost, we estimate SJG cross-subsidized Millennium by approximately \$443,000 in 2001 and by approximately \$587,000 in 2002.

G. Transfer of Risk from Millennium to SJG

In the latest Meter Reading Services Agreement with SJG, Millennium effectively transferred the risk of making a significant investment in new meter reading equipment to SJG. According to the agreement, SJG would be required to pay Millennium \$4,760 per month until December 31, 2006 if the BPU requires the agreement to be terminated. SJG would then own certain meter reading equipment.

H. SJG Charges for Utility Services Provided to Millennium

Charges for SJG employees "leased" and equipment rented to Millennium appeared reasonable. However, neither SJI nor SJG charged Millennium for human resources administration, and Conectiv did not charge Millennium for income tax or insurance functions it provided.³ An agreement signed by SJG and Millennium indicates that administrative service time (including human resources) should be charged to Millennium. Millennium was not allocated a share of SJI's common corporate costs. As such, Millennium's operating costs appear to be less than fully allocated cost.

I. Employee and Asset Transfers

We are not aware of any employee or asset transfers between SJG and Millennium which required disclosure.

³ Human resources administration costs incurred by SJG for the benefit of Millennium were ultimately billed to and retained by SJI.

J. Market Impact

Since its inception in 1999, Millennium's meter reading customers have been limited to the utility affiliates of its owners, SJI and Conectiv. Except as it relates to a limited number of potential customers within the partners' current New Jersey service territories, it is unlikely that Millennium would gain any competitive advantage as a result of its affiliation with SJG.

III. Audit Analysis

A. Organization

Millennium is a joint venture between SJI and Conectiv initially formed for the purpose of providing meter reading services for the southern New Jersey service territories of SJG and Atlantic City Electric Company (an affiliate of Conectiv).⁴ SJI and Conectiv both have a 50% interest in Millennium.⁵

Millennium is managed by a four-member Executive Committee consisting of two representatives from each owner. SJI's current representatives are Albert Ruggiero (Vice President of SJI and Executive Vice President and Chief Administrative Officer of SJG) and Richard Walker (Corporate Secretary & Corporate Counsel of SJI and SJG).⁶

On a day-to-day basis, Millennium is managed by Joseph Scaffidi, General Business Manager. Debra Weingard, Manager of Operations, reports to Mr. Scaffidi. Four operating supervisors and two assistant operating supervisors report to Ms. Weingard. Each of the operating supervisors is responsible for a geographic operating division. The assistant operating supervisors support all divisions on an as-needed basis. Meter readers in each of the operating divisions report to the applicable operating supervisor.⁷ As of July 31, 2002, Millennium had 83 employees.⁸

⁴ OC-58 (Limited Liability Company Operating Agreement of Millennium Account Services LLC), pp. 1 and 5-7. Prior to a full-scale roll-out to the combined service territories of SJG and Atlantic City Electric Company, Millennium was to focus its efforts on the Cape May County, New Jersey area during a pilot period. At some point in time after the initial creation of Millennium, Atlantic City Electric Company began doing business as Conectiv Power Delivery.

⁵ OC-58, p. 10 and interview notes: Albert Ruggiero, October 10, 2002 (Nos. 20 and 23).

⁶ Interview notes: Albert Ruggiero, October 10, 2002 (No. 18) and review of Executive Committee minutes.

⁷ OC-32 (Millennium 2002 Business Plan (dated 8/23/01)), p. 3 and Attachment A and interview notes: Joseph Scaffidi, November 20, 2002 (No. 5).

⁸ OC-16.

B. Separation from Utility**1. Accounting Separation**

Millennium maintains its own accounting system (using Quick Books software) separate from SJG, SJI, or any of their affiliates. Access to Millennium accounting data is restricted. Although SJI "shall have the right during ordinary business hours and upon reasonable notice to inspect and copy [the] books and records"⁹ of Millennium, Company representatives were unable or unwilling to provide the general ledger activity of Millennium either in electronic or hard copy format to us.¹⁰ Millennium performs its accounting function in-house.¹¹ Based on the data provided, the accounting separation between Millennium and SJG appears sufficient.

2. Corporate Governance and Management Separation

Executive Committee members from Conectiv are obviously separated from SJG. However, SJI's Executive Committee members are also officers of SJG. This creates a potential for executives responsible for both Millennium and SJG to be on both sides of the same transaction. In the case of SJG's Meter Reading Services Agreement with Millennium, this problem was handled by having an executive not on the Millennium Executive Committee, Janet Nickels, sign on behalf of SJG. Although not directly responsible for Millennium, Ms. Nickels reports to Mr. Ruggiero.¹²

SJI's small size limits the degree of separation that can be achieved between SJG and the Millennium Executive Committee. We do not believe there is any practical benefit to be obtained by stripping Millennium Executive Committee members of SJG executive responsibilities. However, to the extent possible, responsibility for entering into agreements with Millennium should be delegated to SJG executives who do not report directly to members of the Millennium Executive Committee.

3. Functional Separation

Millennium operates from division offices in Greenfield, Turnersville, Bridgeton, and Egg Harbor Township, New Jersey.¹³ None of these offices are shared with SJG. We believe that Millennium is appropriately separated from SJG in terms of operating facilities.

⁹ OC-58 (Limited Liability Company Operating Agreement of Millennium), p. 20.

¹⁰ OC-40.

¹¹ OC-98 and interview notes: Patrick Finnigan, October 30, 2002 (Nos. 7-8).

¹² Mr. Ruggiero was promoted to Executive Vice President and Chief Administrative Officer of SJG on November 16, 2001 at the same time that Ms. Nickels title changed from Senior Vice President, Sales & Customer Services of SJG to Senior Vice President, Customer Services & External Relations per review of the SJG Board minutes. According to the organization chart dated April 28, 2002, Ms. Nickels reports to Mr. Ruggiero (OC-13). The Meter Reading Services Agreement dated December 1, 2001 between Millennium and SJG was signed by Mr. Ruggiero (Millennium) and Ms. Nickels (SJG). (OC-57)

¹³ OC-32 (Millennium 2002 Business Plan (dated 8/23/01)), pp. 3-4.

Nearly all of the employees reading meters for Millennium are employees of Millennium. When originally formed in 1999, both SJG and Conectiv “leased” utility employees to Millennium. This arrangement was pursued because the union contracts of the utility meter readers prevented SJG from outsourcing this work and laying off union members. Over time, all but one of the union employees have either returned to the utility or left Millennium for other reasons.¹⁴ Millennium presumably reimburses SJG for “all employment costs” of this one remaining SJG-leased employee. These costs include compensation, employee benefits, payroll taxes, certain administrative functions, etc.¹⁵

Since Millennium meter reading employees operate out of unique district offices and have little to no interaction with SJG employees (with the one exception of the SJG “leased” employee), we believe that Millennium’s operations are adequately separated from SJG’s.

4. Asset Separation

- a. Physical Assets - Initially, Millennium leased some assets from SJG (and possibly Conectiv Power Delivery).¹⁶ According to management, all Millennium assets are now either owned outright or leased from third parties.¹⁷ Millennium’s physical assets are primarily located in operating division offices -- the exception being vehicles which are generally taken home by Millennium employees after hours. As such, we believe that Millennium adequately separates its assets from those of SJG.
- b. Information and Information Systems - Operationally, Millennium has separate information systems from those of SJG.¹⁸ However, to provide services to SJG, Millennium has access to SJG’s information systems. Millennium transfers electronic customer usage data from its Itron equipment to SJG’s information systems on a periodic basis. In addition, Millennium employees have access to SJG’s customer information systems in order to enter “premise number” information -- an ancillary service that SJG contracts from Millennium.¹⁹

In accessing SJG’s customer information, Millennium employees are not restricted to screens that contain the premise number field. Some Millennium employees have

¹⁴ Interview notes: Joseph Scaffidi, November 20, 2002 (Nos. 3 and 4) and OC-97.

¹⁵ OC-97 (Employee Seconding Agreement dated January 4, 1999), pp. 3 and 7. A review of the employee listing provided in response to OC-25 indicates only one employee has the title of “Meter Reader”. However, this employee is not listed in Exhibit A of the Employee Seconding Agreement. Per e-mail from Richard Walker on 1/16/03, the Employee Seconding Agreement was not amended to include all employees eventually “leased” to Millennium.

¹⁶ OC-97.

¹⁷ Interview notes: Joseph Scaffidi, November 20, 2002 (Nos. 16 and 38). We found evidence that Millennium did lease certain assets from SJG during the audit period, but the amounts were insignificant.

¹⁸ Interview notes: Patrick Finnigan, October 30, 2002 (No. 7).

¹⁹ Interview notes: Joseph Scaffidi, November 20, 2002 (Nos. 9 and 13) and interview notes: Patrick Finnigan, December 19, 2002 (No. 12).

complete access to all SJG customer information, although “write” capability is strictly limited.²⁰ This access includes, but is not limited to, the identity of customers who use SJG for appliance repair services and the identity of customers who have chosen to purchase gas commodity from affiliated or third-party marketers. Thus, it currently appears possible for Millennium to sell appliance and gas commodity service on behalf of SJI’s competitive service segments while using SJG’s customer data.

As part of its Meter Reading Services Agreement with SJG, Millennium has agreed not to disclose confidential information regarding SJG to others.²¹ Presumably, this would protect SJG from unauthorized release of confidential customer information to potentially interested parties such as Millennium’s other current customer, Conectiv Power Delivery, or to competitive business segments of SJI (e.g., SJE, the ASB, etc.).

C. Business Development, Marketing, Advertising and Sales

1. Marketing Services

Millennium was not engaged in joint marketing with SJG during the audit period.²² We found no evidence that Millennium currently advertises its services on SJG’s or SJI’s internet sites.

2. Utility and Corporate Brand Association

Unlike other entities associated with SJI and SJG, we found no evidence that Millennium shares brand identity with the utility or with SJI.²³

D. Summary of Financial Results

The following table summarizes the financial results of Millennium for the year ended December 31, 2001 and the nine months ended September 30, 2002:

SJG asserts that the following table includes confidential information.

²⁰ OC-93.

²¹ OC-57 (Meter Reading Services Agreement (dated 12/1/01)), p. 3.

²² However, on October 26, 2001, Millennium and SJE entered into a marketing agreement in which Millennium would serve as non-exclusive marketer of SJE services. In return for distributing residential brochures for SJE, Millennium was guaranteed a commission of \$20,000. Through September 30, 2002, Millennium recognized \$38,400 for performing these services. (OC-122 and OC-20) We do not believe this relationship is prohibited by the Affiliate Standards.

²³ Based on a review of the Millennium logo incorporated on business cards and business plans obtained during the performance of the audit.

Table 5-1 Millennium Account Services LLC Summary of Financial Results		
Description	12 Months Ended 12/31/01	9 Months Ended 9/30/02
Meter Reading Revenues:		
SJG	Redacted	Redacted
Conectiv Power Delivery	Redacted	Redacted
Total Meter Reading Revenues	Redacted	Redacted
Other Revenues:	Redacted	Redacted
Total Revenues	Redacted	Redacted
Expenses:		
Payroll Expense	Redacted	Redacted
Payroll Taxes and Employee Benefits	Redacted	Redacted
Leased Labor Expense	Redacted	Redacted
Auto R&M / Fuel / Depreciation	Redacted	Redacted
Maintenance Contracts - Itron	Redacted	Redacted
Other	Redacted	Redacted
Total Expenses	Redacted	Redacted
Net Operating Income	Redacted	Redacted
Other Income (Expense)	Redacted	Redacted
Net Income (1)	Redacted	Redacted
Note 1 - Does not include income taxes. SJI and Conectiv, as partners, are responsible for their respective interests in the taxable income of Millennium.		
Source: OC-18 and OC-20.		

E. Services Provided by Millennium to SJG

1. Inter-Company Meter Reading Services

Millennium recorded \$2,238,909 and \$1,761,773 in revenues from meter reading services provided to SJG in the twelve months ended December 31, 2002 and the nine months ended September 30, 2002, respectively.²⁴ This amounts to 41.1% and 41.9% of total revenues in each of these respective time periods. According to management, Millennium does not track its incurred expenses by customer.²⁵ Therefore, it cannot isolate the profitability of each customer.

²⁴ Primarily derived from a review of OC-11 (affiliate invoices), OC-18 (affiliate financial statements), and OC-20 (trial balances).

²⁵ OC-56.

2. Cross-Subsidization

Affiliate Standards require services not produced for sale on the open market to be priced at the *lower of* fully allocated cost or fair market value.²⁶ Millennium is a service company of SJI and Conectiv. It does not and has not provided services to non-affiliated companies.²⁷ As such, our interpretation is that it is subject to the BPU's "lower of cost or market" requirement. As shown below, Millennium's fully allocated cost appears to be lower than market prices and is therefore the basis for assessing cross-subsidization. We estimate SJG cross-subsidies to Millennium to be \$443,000 in 2001 and \$587,000 in 2002

- a. Market Prices - In 2000, SJG obtained two bids for meter reading services that were nine and 14 percent lower than the prices charged by Millennium.²⁸ SJG did not accept either bid. These bids can be used as one basis for calculating a cross subsidy. If the market price, as evidenced by the average of the two bids, is lower than Millennium's prices by approximately 12 percent, SJG's cross-subsidy of Millennium (based on market comparables) would be 12 percent of the amounts it paid to Millennium. This would be \$269,000 in 2001 and \$211,000 for the first 9 months of fiscal year 2002 (\$282,000 annualized).
- b. Fully Allocated Cost Prices - When we applied the fully allocated cost definition described in Chapter 2 to the meter reading services provided by Millennium, we found that SJG's contribution to Millennium's profits exceeded a return on investment calculated using SJG's cost of capital by approximately \$443,000 in 2001 and \$440,000 for the first nine months of fiscal 2002 (\$587,000 annualized). This is shown in the following table. The fact that fully-allocated cost cross-subsidy calculations exceed similar calculations based on market comparables is an indication that the fully allocated cost of Millennium's service is somewhat lower than market comparables.²⁹ As such, fully allocated cost is the governing basis for pricing under the "lower of fully allocated cost or market" rule. We estimate that SJG cross-subsidized Millennium and SJI by \$443,000 in 2001 and \$587,000 in 2002.

²⁶ Affiliate Standards 14:4-5.5(t)6.

²⁷ Interview notes: Joseph Scaffidi, November 20, 2002 (No. 8).

²⁸ In August, 2000 SJG solicited bids for meter reading services from four unaffiliated companies and received two quotes. One company submitted a bid of \$0.55 per meter in August of 2000 and the other vendor submitted a bid of \$0.58 per meter in September of 2000. On average, these two bids represent an 11.7% savings to the Millennium price of \$0.64 per meter, exclusive of a performance bonus which had recently been added to the SJG-Millennium agreement. While more recent data would be preferable in establishing fair market value during the audit period, this was not acquired by SJG.

²⁹ This is not surprising when the economies of combining Conectiv's electric and SJG's gas reads are considered.

Table 5-2 Estimate of SJG Cross-Subsidy Based on Fully Allocated Cost		
Description	2001	2002
Millennium Reported Pre-Tax Income	\$ Redacted	\$ Redacted
Millennium Asset Balance at Beginning of Period	Redacted	Redacted
Millennium Asset Balance at End of Period	Redacted	Redacted
Millennium Average Asset Balance	Redacted	Redacted
Times: SJG Approved Pre-Tax Rate of Return	Redacted	Redacted
Estimated Millennium Return Consistent with Fully Allocated Cost, Annualized	Redacted	Redacted
Times: Fraction of Year	Redacted	Redacted
Estimated Millennium Return Consistent with Fully Allocated Cost, 2001 and 9 months 2002	Redacted	Redacted
Excess Millennium Return	Redacted	Redacted
Times: SJI's Interest in Millennium Return (Approx. of SJG business)	Redacted	Redacted
SJG Cross-Subsidy of SJI 2001 and 9 months 2002	Redacted	Redacted
SJG Cross-Subsidy of SJI 2001 and 2002 Annualized	Redacted	Redacted
Sources: Reported Pre-Tax Income and Asset Balances (OC-18 and OC-20) SJG Approved Rate of Return derived from after-tax rate (OC-2: Section M-14)		

1. SJG's Justifications for Millennium Prices and Profits

We believe the analysis above is the most appropriate basis for judging the prices charged by Millennium to SJG. However, we asked SJG management to provide any New Jersey regulatory precedent that it believed supported the reasonableness of the prices charged and inter-company profits earned by Millennium. In response, SJG summarized several cases involving various jurisdictions throughout the United States. SJG's interpretations of these cases are paraphrased as follows³⁰:

- C It is presumed that investor-owned affiliates of a public utility will make a profit on sales to the public utility. Some states require that the profit be "reasonable".³¹

³⁰ OC-124.

³¹ General Telephone of the Midwest, 3P.U.R.4th 133 (Iowa S.C.C 1974).

- C Some states (but not New Jersey) require the public utility commission to scrutinize affiliate transactions and related profits when determining reasonable rates for the utility.³²
- C The BPU is not permitted to scrutinize the accounting books and records of an unregulated affiliate, but may inquire into the level of expenses of the utility to insure that the same are reasonable.³³
- C “The proper allocation of costs on the books of each company” takes precedence over the profitability of a transaction between a regulated public utility and an affiliated, regulated corporation.³⁴
- C The BPU has sanctioned the business plan of an affiliate of a regulated utility which was aimed at improving profitability.³⁵
- C Disallowing a company the opportunity to earn a reasonable profit would constitute an unconstitutional taking in violation of the due process clauses of the United States and New Jersey constitutions.³⁶

SJG’s interpretations of the cited cases can be boiled down to the following two assertions: 1) Millennium is entitled to earn a “reasonable” profit in providing services to SJG and 2) The BPU’s right to scrutinize Millennium’s financial results is strictly limited. We address each of these assertions below:

- a. Millennium is entitled to earn a “reasonable” profit in providing services to SJG - We agree. The question is “What is a reasonable profit?” The Affiliate Standards provide for a profit in affiliate transfer prices by defining fully-allocated costs to include “economic costs of assets utilized.” The “economic costs of assets” includes a return *on* capital (earnings) and a return *of* capital (depreciation). In calculating SJG’s cross-subsidy of Millennium we have provided allowances for both return on and return of capital. This raises a second question: What earnings rate should be applied to utilized assets? The answer to this also seems clear. As SJG points out in one of its interpretations above, the BPU has a right to determine whether utility expenses incurred from services provided by affiliates are reasonable. We believe the reasonable rate of return for an affiliate such as Millennium with two captive customers that happen to be utilities is the rate of return allowed by the BPU for those utilities. We used SJG’s allowed rate of return in calculating SJG’s cross-subsidy of Millennium.

³² GTE South, 123 P.U.R.4th 257 (W.Va.P.S.C)

³³ New Jersey Bell v. Bd.of Public Utility Commissioners, 12 N.J. 568, 591(1953).

³⁴ 154 P.U.R.4th 445 (N.J.B.R.C 1994).

³⁵ 144 P.U.R.4th 351 (N.J.B.P.U 1993)

³⁶ East Cape May Assoc. v. N.J.D.E.P. (Dept of Environmental Protection), 343 N.J. Super.110 (App. Div. 2001).

- b. The BPU is not permitted to scrutinize the accounting books and records of an unregulated affiliate. We do not agree that this assertion applies to Millennium, nor do we believe that SJG believes it.³⁷ Taken to an extreme, SJG's interpretation of the BPU's limited rights could be taken to mean a utility can out-source not just meter reading to affiliates, but its entire operation, with a result that leaves the BPU stripped of its right to "scrutinize" the entire cost of utility operations. It is conservative to say that such an assertion is far-fetched. Millennium was created by extracting a *utility* function - meter-reading - from two regulated companies and selling that same function back to the utilities at a profit. It does not seem likely that the BPU intended to cede its right to review the costs of providing meter reading services - be it at a general or detailed level - simply because SJG decided to place the function within the legal boundaries of an affiliate.

4. Economic Savings Generated by Millennium

The economic justification for Millennium is that by combining the electric and gas meter reading in Conectiv Power Delivery's and SJG's overlapping territories, Millennium can extract an economic savings that neither of its owners could obtain on their own. SJG estimates that it saved \$672,864, \$531,920, and \$360,740 in 1999, 2000, and 2001, respectively, by moving its meter reader function to Millennium.³⁸ However, SJG did not provide supporting detail to enable us to determine whether its savings calculations are reasonable. It should be noted that it is possible that the economies of combining the Conectiv Power Delivery and SJG meter reading function creates a situation in which SJG is both saving money compared to providing the service internally by itself and is at the same time cross-subsidizing Millennium by paying a price that provides for a return on investment higher than the BPU rate of return authorized for SJG.

F. Services Provided and Assets Leased by SJG to Millennium

1. Employee Agreement

When Millennium was originally created, SJG and Millennium entered into an Employee Seconding Agreement in which SJG "leased" employees to Millennium. This was necessary to gain labor union support for the proposed joint venture. Over time, as Millennium's former utility workers found new positions within the utilities, the employees used by Millennium to read meters were replaced by new non-union employees. The terms of this agreement called for Millennium to reimburse SJG for all compensation, employee benefits, payroll taxes, etc. related to these employees.³⁹ During the twelve months ended December 31, 2001 and the nine months ended September 30, 2002, SJG charged \$86,314 and \$44,985, respectively, to Millennium for these costs. The amount of these costs appears reasonable given that at the

³⁷ Although they did not respond to our request for Millennium's general ledger detail, SJG provided Millennium's financial results to us.

³⁸ OC-77. Note that SJG believes these figures are also conservative in that they do not account for increases in payroll, benefits, and staffing increases if SJG had continued to perform the function in-house.

³⁹ OC-97.

beginning of 2001, SJG was only leasing two employees to Millennium, and by the fourth quarter of 2002, this number had dwindled to one employee.⁴⁰

2. Leased Assets

During the audit period, SJG leased certain assets to Millennium (monthly rent ranged from \$482 to \$1,303).⁴¹ Based on attachments to the lease dated May 25, 2000, the monthly rent was set to recoup the depreciation expense and insurance costs of the specifically identified equipment.⁴²

3. Corporate Administrative Services

On an as-needed basis, SJG's Information Services Department provided services to Millennium. These costs were billed at a transfer price designed to recover certain costs of the department. These charges were discussed further in Chapter 3. In the twelve months ended December 31, 2002 and the nine months ended September 30, 2002, the Information Services Department billed Millennium \$1,350 and \$17,170, respectively.⁴³

In its original agreement with Conectiv to form Millennium, SJI and Conectiv both agreed to perform certain services. Although we were not provided a copy of either the SJI or Conectiv Administrative Services Agreements⁴⁴, management told us that SJI was selected as the "human resources partner" and Conectiv was selected as the "tax partner".⁴⁵ In its capacity as "human resources partner", SJI was assigned the task of providing employee benefits to Millennium employees and providing certain human resources services to Millennium. Likewise, as the "tax partner", Conectiv was to provide income tax services to Millennium. Management also said that Conectiv handled Millennium's insurance matters.⁴⁶ While the outside costs of providing these services are passed through to Millennium (e.g., insurance premiums associated with employee benefits, insurance premiums associated with company property and liability insurance, etc.), neither SJI nor Conectiv bills the time spent by their employees (or their affiliates' employees) to Millennium. In the case of SJI, labor costs associated with supporting Millennium (usually originating at SJG) were directly assigned to SJI (via time sheets), and ultimately retained by SJI. During the twelve months ended December 31, 2001 and the nine months ended September 30, 2002, the labor costs associated with Millennium business that

⁴⁰ OC-32 (Millennium 2002 Business Plan (dated 8/23/01)), p. 4 and interview notes: Joseph Scaffidi, November 20, 2002 (No. 4).

⁴¹ Derived from OC-11.

⁴² OC-97.

⁴³ Derived from OC-11.

⁴⁴ Although not requested by name, both of these agreements were exhibits to the Limited Liability Company Operating Agreement of Millennium provided in response to OC-58. However, these exhibits and others were not sent to us for review as of the date of this report.

⁴⁵ Interview notes: Albert Ruggiero, October 10, 2002 (No. 30).

⁴⁶ Interview notes: Joseph Scaffidi, November 20, 2002 (Nos. 14 and 15).

were retained by SJI amounted to \$12,587 and \$5,866, respectively.⁴⁷ Most of these costs were associated with SJG executives who also served on the Millennium Executive Committee. If similar amounts were not billed to Millennium by Conectiv in performing income tax and insurance work, the costs of Millennium would have been understated by approximately \$37,000 during the audit period (January 1, 2001 to September 30, 2002). Had this work been properly accounted for, it would have had an immaterial effect on the cross-subsidization calculations discussed above.

On July 1, 2002, SJG and Millennium signed an Administrative Services Agreement. According to the terms of this agreement, "the cost of the Administrative Services rendered . . . shall be determined in accordance with South Jersey Industries, Inc's formal Cost Allocation Manual."⁴⁸ Administrative services include secretarial and other administrative support, human resources services, management and information systems services, data processing services, mail room services, and equipment rental.⁴⁹ According to SJI Cost Allocation Manual Procedure T-8, "employees [sic] time (including pay rate and benefit rate) is charged monthly to designated subsidiary, and competitive service where applicable, based upon time sheets prepared by each employee."⁵⁰ As mentioned above, Millennium was not billed by SJG or SJI for these administrative services during the audit period. At a minimum, in order to accurately accumulate fully allocated costs, SJG should conform to the terms of its current agreement with Millennium by retroactively billing all administrative services costs to Millennium from July 1, 2002 to present and by billing costs for future services as agreed. Millennium, in turn, should record these costs as operating expenses of the business.

Millennium was not the cost objective for common costs that SJI allocated among its various affiliates and subsidiaries during the audit period.⁵¹ Further discussion of corporate cost allocations can be found in Chapter 3.

G. Employees and Assets Transferred to Millennium

SJG reported no employee transfers between SJG and Millennium from the beginning of 2000 to the end of September, 2002.⁵² During the audit, we did not observe any transfers of assets between SJG and Millennium.

⁴⁷ Derived from OC-11. We noted that Human Resources' personnel from SJG only charged seven hours of time to Millennium during the entire first nine months of 2002. While HR management has indicated that interaction with Millennium had been infrequent in the latter half of 2002, we suspect that the such mundane tasks as coding all of the employee benefits during a nine-month period (even if properly allocated to all the various affiliates) would result in more than the reported seven hours. As a result, the amounts retained by SJI and not billed to Millennium are likely understated.

⁴⁸ OC-17 (Exhibit B).

⁴⁹ OC-17 (Exhibit A).

⁵⁰ OC-2.

⁵¹ OC-2 (Section C-1).

⁵² OC-27.

Chapter 6 - South Jersey Energy Co.

Chapter 6 - South Jersey Energy Company

I. Introduction

This chapter covers the relationships and transactions between South Jersey Gas Company (SJG) and South Jersey Energy Company (SJE), and to a lesser extent, its wholly-owned subsidiary, SJ EnerTrade, Inc. and its two joint ventures, AirLogics, LLC and South Jersey Energy Solutions, LLC. SJE is South Jersey Industries, Inc.'s (SJI) retail energy supplier and marketer. SJE also performs energy management services for larger customers.

II. Summary of Audit Findings

A. SJG Separation from SJE

SJE maintained separate accounting books, maintained an employee organization distinct from SJG, segregated its office space from SJG and restricted access to SJG information systems. Despite these steps, management and functional separation between SJG and SJE remains inadequate in several respects. As discussed below, SJE uses SJG employees to take customers away from the utility.¹ SJE executive management participates in meetings that involve SJG. SJG's employees are involved in a "Community Rewards" program which provides them financial incentives to get SJG customers to switch to SJE for purposes of purchasing the gas commodity. Although functionally separate on paper and in terms of office space, as a result of common interest and overlapping corporate management, SJI, SJE and SJG act together in the interest of SJI and its shareholders, and these interests are not fully aligned with the interests of SJG's ratepayers. SJG and SJE are not effectively separated and they do not compete with one another.

B. SJG and SJE Market Inter-Relationships

During the audit period SJE captured approximately one-fourth of the residential customer base in SJG's service territory and 82 percent of the residential customers who left the utility. This was accomplished by guaranteeing residential customers a 4 cent-per-therm discount from SJG's "price to compare".² Several factors create an environment in which SJE has both an inherent cost advantage over SJG and a significant marketing advantage over its non-utility gas marketing competitors. These include: 1) SJG's relatively high basic gas supply service cost, which creates a significant buffer ([redacted]) to be divided between SJE's discount and mark-up over cost; 2) SJG's competitive disadvantage as the supplier of last resort; 3) the infrequency of SJG's recalculation of the levelized gas adjustment clause (LGAC) which eliminates much of SJE's pricing risk; and 4) the competitive advantage SJE enjoys in the SJG service territory because of its close association with the utility.

¹ Management represents that this is only done on an after-hours basis (SJG comments to draft report). These activities only involve the gas commodity. Transportation of the gas commodity is still provided by the utility.

² This offer was generally also combined with a gift card to a local retail store.

The convergence of these factors permits SJE to show customers they have “nothing to lose” by leaving the utility: they are guaranteed a discount for at least one heating season, their service is effectively managed by the same executives who manage the utility, and they can switch back to the utility the next year for commodity service if for some reason the discounts are not available. It does not appear that SJE’s discounting practices are at variance with Affiliate Standards. However, one potential consequence of this set of market dynamics is the migration of a significant portion of SJG customers to SJE, leading to an increased LGAC burden on the remaining SJG customers as the costs of SJG’s supplier-of-last-resort responsibilities and costs are spread over a shrinking utility customer base.³ Another potential consequence is an increase in the total costs of supplying the retail market in SJG’s territory, as SJE’s marketing costs and profit margins are added to a potentially unchanged total cost of gas supply.⁴

C. Marketing Programs at Variance with Affiliate Standards

SJE uses SJG employees to sell its services to customers in both its “Community Rewards” and “In-Home Brochure” programs. SJE compensates SJG employees for taking business from SJG and directing it to SJE. During the audit period, SJG employees were paid approximately \$120,000 by SJE over and above their regular SJG salaries and wages. SJG management believes it is acceptable for one competitive business segment (the Appliance Service Business) to market another competitive segment’s (SJE’s) services even though one of the businesses is part of the gas utility. However, SJG’s position does not adequately explain why SJG employees not working for the Appliance Service Business should be paid to promote SJE services. We believe that this practice is at variance with Affiliate Standards.

D. Telemarketing Practices at Variance with the Affiliate Standards

The Affiliate Standards require that disclaimers accompany competitive business segment marketing and advertising. An SJE telemarketing script provided to us by SJG did not include the appropriate disclaimers.

³ Primarily, these include the costs of maintaining capacity to supply gas based on SJG’s design day requirements. SJE has no such requirement. This places SJE at an inherent advantage relative to SJG.

⁴ Based on our interview with Jeffrey DuBois, SJG’s Assistant Vice President Gas Supply, we have no reason to believe that apart from the constraints SJG faces as supplier of last resort, SJG cannot purchase the gas commodity at a price as low as SJE. There is no reason to believe SJG’s supplier-of-last-resort or its total gas costs will decrease because SJE or other competitors are in the market (in fact, SJG’s incentive is just the opposite - higher utility gas costs encourage customer migration to an affiliate that, unlike the utility, is permitted to earn a profit on gas sales). As such, the total costs of gas supply resulting from competition appear to be unchanged at best. At the same time, SJE and other marketers add two new costs: their own marketing costs (costs that SJG does not have) and a profit margin (which SJG lacks because the LGAC is only a cost-passthrough). If non-utility marketers’ unique costs (marketing and profit) are added to an unchanged total cost of gas supply, total costs borne by customers in the market are higher.

E. Utility and Corporate Brand Association

SJI, SJG and SJE managers (some of whom have overlapping utility, holding company and / or affiliate responsibilities) have aligned SJE with the corporate and utility brands to take advantage of the trust and name recognition of the incumbent utility. Although not prohibited by the Affiliate Standards, the alignment of SJE with the utility provides SJE with a competitive advantage over others selling gas in SJG's service territory.

F. SJI / SJG Cross-Subsidization of SJE

SJG effectively subsidizes all non-utility participants in the gas commodity market by shouldering the entire set of costs created by its supplier-of-last-resort responsibilities. It is not possible to quantify this cross-subsidy. Without it, SJE and other marketers would probably not be able to operate in the residential market unless they were able to otherwise procure gas at prices lower than SJG.⁵

We believe that certain shared corporate service costs and shared utility costs were not properly calculated, and the allocations to SJE were likely understated while SJG's were likely overstated. However, due to a lack of cost accounting information and data, we are unable to quantify the understatement of allocated costs.

G. Inter-company Services between SJG and SJE

SJE provided SJG significant energy management services in the months and years prior to the audit period. However, given the relative immateriality of payments made during the audit period, we did not test the appropriateness of the prices between SJG and SJE. We were not made aware of any gas commodity sales from SJE to SJG.⁶

SJG provided shared corporate and utility services to SJE. In many cases, the limited cost support suggested that SJE was not allocated an attributable share of these costs. However, we were unable to quantify the exact amount of understatement. (See Chapter 3 for further detail) SJG also sold the gas commodity to SJE during the audit period although the amounts involved were relatively immaterial to SJG's total revenues. Management has represented that it did not offer discounts on these sales that required disclosure under the Affiliate Standards.

⁵ To the extent SJE and other marketers could supply SJG's territory with lower-priced gas, while at the same time bearing a share of duty-to-serve costs, it could call into question the prudence of SJG's gas supply plan.

⁶ However, management's insistence that requests for data related to inter-company eliminations was beyond the scope of our audit and its additional inference that we should accept other auditors' conclusions without question does not permit us to conclude that such transactions did not actually occur (see OC-79).

H. Employees Transferred to / from SJE

According to SJG management, in 2002 SJG transferred one employee to SJE, and SJE transferred one employee to SJG. We could not independently verify this information since SJG was unable to provide employee listings from prior years.

III. Audit Analysis

A. Organization

SJE is a wholly-owned subsidiary of SJI, formed on December 21, 1972.⁷ During the audit period, SJE was a licensed, deregulated energy supplier for residential, commercial and industrial customers located primarily in the SJG service territory. SJE also marketed energy management services. SJE had one subsidiary during the audit period -- SJ EnerTrade, Inc. (EnerTrade).⁸ Although EnerTrade had a more substantial role in years past (including holding the organization's interest in South Jersey Resources Group, LLC), according to management, EnerTrade now only has a few contracts with Atlantic City, New Jersey casinos to sell natural gas. When these contracts expire, management intends to fold the company into SJE.⁹

SJE and GZA GeoEnvironmental, Inc. both hold a 50% interest in AirLogics, LLC, an entity which markets a patented, real-time, air quality monitoring system.¹⁰ For the twelve-month period ended December 31, 2001 and the nine-month period ended September 30, 2002, SJE's 50% interest in AirLogics, LLC contributed \$142,000 and \$87,000, respectively, of net income to SJI.¹¹

Finally, SJE and Energy East Solutions, Inc. formed a joint venture named South Jersey Energy Solutions, LLC in 1999 to market retail electricity and energy management services. While management represented that this entity was inactive during the audit period, this is inconsistent with the status noted on the BPU internet website of licensed suppliers of electricity which was last updated on October 21, 2002.¹² According to management, this apparent discrepancy is the result of South Jersey Energy Solutions, LLC's decision to maintain a New Jersey supplier license for potential future use.

⁷ OC-16 and December 31, 2001 SJI Form 10-K.

⁸ Company Profile provided by Executive Management on October 31, 2002 and December 31, 2001 SJI Form 10-K.

⁹ Interview notes: Executive Management presentation, October 31, 2002 (No. 2).

¹⁰ Company Profile provided by Executive Management on October 31, 2002 and interview notes from Executive Management presentation on October 31, 2002 (No. 4).

¹¹ OC-88 (Part 2).

¹² December 31, 2001 SJI Annual Report to Shareholders and interview notes: Executive Management presentation, October 31, 2002 (No. 3).

As reported by SJI, SJE consisted of twelve employees as of June 30, 2002.¹³ However, two of these employees, Edward Graham and Michael Renna, were paid by SJI and reported their time as if they were SJI employees.¹⁴ In addition, SJI housed a commercial and industrial sales staff that primarily supported SJE during the audit period that was not included in the figure cited above.¹⁵

Given the relative immateriality of the subsidiary and joint ventures of SJE, unless specifically noted otherwise, references to SJE in the remainder of this chapter are meant to incorporate SJE, EnerTrade, AirLogics, LLC, and South Jersey Energy Solutions, LLC.

B. Separation from Utility

1. Accounting Separation

SJE maintained a separate general ledger from SJG during the audit period. SJE employed a different accounting software program (Solomon) than SJG.¹⁶ SJE's day-to-day accounting was handled by an accounting group separate from SJG's internal accounting staff.¹⁷ SJE's accounting was effectively separated from SJG's accounting.

2. Corporate Governance and Management Separation

During the audit period, SJE reported through Edward Graham to Charles Bisciegla, Chairman of the Board, President, and CEO of SJI. Mr. Graham was the President and a member of the Board of Directors of SJE. He also held the titles of Executive Vice President and COO of SJI (effective November 16, 2001).¹⁸ Effective January 1, 2003, Mr. Graham became SJI's President and COO and SJG's President. Mr. Graham also began to serve on SJG's Board of Directors.¹⁹ According to Mr. Graham, he relinquished his titles with SJE at that time.²⁰

Organizationally, the day-to-day management of SJE was separate from SJG. According to the job descriptions made available to us, SJE employees did not have conflicting responsibilities with SJG.²¹ However, this has not affected SJE's ability to take strategic advantage of its

¹³ OC-13.

¹⁴ Interview notes: Edward Graham, December 18, 2002 (No. 5) and Michael Renna, December 17, 2002 (No. 3).

¹⁵ Interview notes: Thomas Kavanaugh, November 1, 2002 (No. 4).

¹⁶ Interview notes: Thomas Kavanaugh and David Robbins, January 14, 2003 (No. 5).

¹⁷ Interview notes: Thomas Kavanaugh, November 1, 2002 (No. 7).

¹⁸ OC-13 and review of Board of Directors' minutes.

¹⁹ November 26, 2002 SJI news release.

²⁰ Interview notes: Edward Graham, December 18, 2002 (No. 2).

²¹ OC-64.

competitive position relative to SJG or its ability to use SJG to advance its marketing efforts. Thus, the appearance of management separation created by corporate organization charts and job descriptions does not appear to translate into operations. Put simply, the management of SJE and SJG act in the interest of SJI and its shareholders; they do not compete with one another.

As it relates to the separation of SJE's corporate governance and management from SJG during the audit period, two specific items are worth noting. Although he now no longer retains the title of Secretary of EnerTrade, Richard Walker served as both a corporate officer of EnerTrade (a company-acknowledged related competitive business segment²²) and a corporate officer of SJG during the entire audit period.²³ This is expressly prohibited by the Affiliate Standards.²⁴

In addition, while SJG may have complied with the Affiliate Standards concerning management separation as currently written, it should be noted that such compliance did not effectively separate the management of the two businesses. SJE's executive management routinely attended Board of Directors' meetings during the audit period in which SJI, SJG and SJE business was discussed. SJE's executive management also sat in on monthly meetings in which the regulated utility's operating results were discussed.²⁵ SJG's new President was previously SJE's President. Although changes in job titles give the appearance of proper management separation, SJE's and SJG's management are not separate in practice.

3. Functional Separation

At times, the separation between SJE and SJG employees may be difficult for the public to distinguish. SJE has employees whose responsibilities included fielding customer questions and concerns related to SJE-sold gas commodity.²⁶ Because SJE uses SJG to bill its residential customers, SJG customer service center employees also handle some general inquiries from SJE gas-commodity customers (as they would for any gas marketer using their service). This service was included in the customer service charge of \$0.075 per bill from SJG to SJE.²⁷

²² OC-9.

²³ Interview notes: Richard Walker, December 13, 2002 (Nos. 1 and 10).

²⁴ Affiliate Standard 14:4-5.5(q)1.

²⁵ Interview notes: Edward Graham, December 18, 2002 (Nos. 8 and 9). When management was asked by an employee in the company newsletter why SJE personnel were permitted to attend such meetings, management attempted to diffuse the situation by focusing on the need for open lines of communication between subsidiaries rather than compliance with the Affiliate Standards (OC-28: Issue 19, August 26, 2002).

²⁶ Interview notes: Richard Walker, October 8, 2002 (No. 11) and OC-64.

²⁷ Interview notes: Bonnie Bornstein, October 30, 2002 (No. 2).

During the audit period, SJG employees received financial incentives to solicit the transfer of SJG utility customers to SJE as it relates to gas commodity.²⁸ Such actions contribute to confusion concerning the separation between SJG and SJE in the minds of consumers. In addition, SJE's brand image was closely tied to SJG's. Both companies employed common logos and slogans. To the extent that SJE employees circulated promotional materials or official company correspondence with the common brand, the distinction between SJE employees and SJG employees was blurred. Marketing practices designed to associate SJE with SJG are discussed further in the following section.

4. Physical Separation

According to the most recent employee list, all SJE employees were located in the Folsom, New Jersey facility.²⁹ On a tour of the Folsom headquarters, we noted that the rank-and-file SJE employees were physically segregated from the rest of the employees located in this facility. The then current President of SJE (who was also an SJI executive officer) was located in the executive office area with all other SJI and SJG executive officers.

Without taking the additional step of having its own dedicated facility, we believe that SJE has adequately physically segregated its employees from SJG employees. However, the practical effect of physical separation on SJE's ability to interact strategically with SJG is negligible.

5. Asset Separation

- a. Physical Assets - Based on a review of the consolidating balance sheets of SJI at December 31, 2001 and September 30, 2002, SJE had negligible physical assets. Most were intangible in nature such as accounts receivable, unbilled revenues, and prepayments.³⁰ To the extent that tangible assets such as furniture and equipment were located in the segregated office area of SJE, we believe there was adequate separation of physical assets between SJE and SJG.
- b. Information and Information Systems - Management represented that SJE either did not have access to or did not use the following primary SJG information systems: customer billing, electronic bulletin board, physical energy tracking and SCADA.³¹ As previously noted, SJE maintained its own separate accounting system. Management represented that utility customer data was not provided to SJE either directly or indirectly during the audit period.³² Nothing came to our attention to contradict these representations.

²⁸ Management represents that such solicitation occurred strictly on an after-hours basis.

²⁹ OC-25 (Division 5 with no other "location" listed).

³⁰ OC-79.

³¹ Interview notes: Michael Renna, December 17, 2002 (Nos. 15, 16, and 28), Jeffrey DuBois, December 20, 2002 (Nos. 1 and 4), and Bonnie Bornstein, October 30, 2002 (No. 29).

³² Interview notes: Joseph Scheufele, November 22, 2002 (No. 19), Michael Renna, December 17, 2002 (No. 16), and Edward Graham, December 18, 2002 (No. 20).

Information and information systems appear to have been adequately segregated between SJE and SJG.

C. Business Development, Marketing, Advertising and Sales

1. Cross-Marketing

During the audit period, SJE used a number of methods to market its products and services. These included outbound telemarketing, direct mail, the “Community Rewards” program, and the “In-Home Brochure” program to name a few. According to management, SJE did not use utility bill inserts to promote SJE.³³

We made the following observations in evaluating SJE marketing practices for compliance with Affiliate Standards.

2. SJE Price Peg to SJG’s “Price to Compare”

During the audit period, SJE promoted its residential, commercial, and industrial retail gas services by guaranteeing savings pegged to the SJG “price to compare”. In the case of SJG residential customers, the savings were set at a 4-cent-per-therm discount to SJG’s “price to compare”. The residential customer promotion was generally accompanied by a gift card redeemable for merchandise at a local retail store (e.g., The Home Depot, Acme, Shop-Rite, etc.). Commercial and industrial customers were eligible for a 12% per decatherm savings below SJG’s “price to compare”.³⁴

A review of SJG’s “price to compare” indicates that it was primarily composed of the commodity and non-commodity cost of gas (together referred to as Basic Gas Supply Service) with small adjustments for prior year under-recoveries of the LGAC and the balancing service clause, all of which was divided by therm sales to arrive at a price.³⁵

We did not audit the accuracy of the individual components of the “price to compare” nor did we attempt to determine the prudence of the costs incurred by the utility in providing service to its customers. However, the following observations are noteworthy:

- C As summarized in the following table, SJG’s Basic Gas Supply Service (BGSS) charge for residential customers was significantly higher than other comparable gas utilities in New Jersey, providing a significant buffer within which SJE was able to profitably price its own gas:

³³ Interview notes: Joseph Scheufele, November 22, 2002 (Nos. 6 and 19), OC-108, and OC-121.

³⁴ OC-118 (Commercial and industrial customers eligible for discount were those met the qualifications of a GSG-FT customer under the SJG tariff.).

³⁵ OC-129 and SJG Tariff.

Table 6-1 New Jersey Gas Utilities Basic Gas Supply Service (BGSS) Charges Residential Service As of December 31, 2002	
Utility Name	BGSS per Therm
South Jersey Gas Company	\$ 0.6715
Elizabethtown Gas Company	\$ 0.5751
New Jersey Natural Gas Company	\$ 0.5238 - 0.5548
Source: Applicable tariffs.	

We did not perform analysis to determine why SJG's BGSS price is higher than that of its neighboring New Jersey gas utilities. We note, however, that this price works directly to the advantage of SJE. Other variables being the same, the higher SJG's BGSS price, the greater the profit potential for SJE. In theory, this advantage holds true for all market participants. However, the fact that SJE has captured 82 percent of the residential non-utility gas market suggests that other factors (SJG and SJE shared strategic objectives and SJE's affiliation with the utility brand) may give SJE an insurmountable advantage over its competitors.

- C Unlike SJG, SJE and other gas marketers are not burdened with the costs of being the supplier of last resort. Since SJG alone must incur certain supply and pipeline capacity costs to meet peak demand requirements, it has an inherent cost disadvantage relative to non-utility marketers, including its own affiliate.
- C Historically, SJG has only requested changes to its LGAC on an annual basis.³⁶ Because price stability is an important feature in luring customers away from the utility, SJG's unchanging LGAC works directly to the advantage of SJE. If SJG and SJE were actually competitors, SJG might be expected to make it more difficult for SJE to lure customers by adjusting its LGAC more frequently, as other New Jersey utilities do. The fact that this is not done is evidence of the strategic alignment of SJG and SJE with the interests of SJI. It should be noted that regulatory rules prevent SJG from profiting from the sale of the gas commodity and more or less guarantee the full recovery of prudently incurred gas purchase costs; hence, SJG has no incentive to compete against SJE. Thus, alignment of SJG's and SJE's strategic interests is entirely expected.
- C Other gas marketers in SJG's service territory do not have the advantage of name recognition that comes from affiliation with the utility brand. In some cases, they may not

³⁶ Interview notes: Jeffrey DuBois, December 18, 2002 (No. 30) and Edward Graham, December 18, 2002 (No. 12). According to management, effective December of 2002, SJG has been approved to adjust its LGAC up to three times annually (SJG comments on draft report). Since it is management's prerogative to file an adjustment to SJG's LGAC, such approval is not necessarily an indication that more frequent filings will occur in the future.

have the motivation to compete against SJE when SJE has what some economists would consider a monopoly (82 percent of the residential non-utility market).³⁷

- C SJE and other marketers do not appear to have an impact on SJG's total cost of gas supply. As a result, the more successful SJE becomes, the higher the cost of gas for remaining utility customers, as the fixed component of SJG's gas cost (the capacity costs associated with being the supplier of last resort and unrecovered costs from prior years) are concentrated and spread over a smaller customer base. Since the "price to compare" is based on a cost per therm sold, the resulting calculation increases (as the denominator decreases) and it becomes easier and easier for SJE to beat SJG's "price to compare" -- theoretically, driving more SJG customers to SJE.

3. "Community Rewards" and "In-Home Brochure" Programs

SJE created a "Community Rewards" program to provide incentives to individuals or organizations that could persuade SJG residential utility customers to switch to SJE for their gas commodity. While particular details of the program are somewhat confusing,³⁸ it is clear that SJE actively solicited SJG employee involvement to convince residential customers in SJG's service territory to purchase the gas commodity from SJE.³⁹ It is almost certain (given SJE's predominance among non-utility retail marketers) that the vast majority of the customers targeted in this promotion were formerly SJG firm sales service utility customers rather than converts from other gas marketers.

In addition to this program, SJE used the appliance service technicians (ASTs) of SJG to disseminate marketing brochures while providing appliance services. This was known as the "In-Home Brochure" program. The brochure handed out by ASTs promoted both Appliance Service Business (ASB) and SJE services.⁴⁰ It is not known if the ASTs were paid additional incentives over and above that which was earned in the "Community Rewards" program. However, the total incentives paid by SJE to SJG employees amounted to \$123,060 for the time period from mid-2001 through October, 2002.⁴¹

³⁷ Currently, non-utility marketers serve approximately 85,000 residential customers in SJG's service territory. Of these, 70,000 (82.4%) are served by SJE. Source: Interview notes: Michael Renna, December 17, 2002.

³⁸ Given the conflicting information provided in interviews and data requests, it is not clear to us whether 1) employees are the only parties that are paid incentives directly vs. through a contribution to a chosen charity, 2) the incentive is \$10 or \$20 per successful lead, 3) and the \$20 incentive (if applicable) is required to be shared between the employee and a charity of his/her choice (\$10 to each) (see interview notes: Robert Fatzinger, October 29, 2002 (No. 60), OC-121, and OC-28 (multiple references in "SJI Today" newsletter).

³⁹ We counted at least 6 references to the "Community Rewards" program in the "SJI Today" newsletter between August 2001 and June 2002. Many of these references included solicitations to participate in the program (OC-28).

⁴⁰ OC-108.

⁴¹ OC-28 and OC-71.

Affiliate Standards prohibit gas public utilities from providing leads to a competitive business segment of its public utility holding company, soliciting business on behalf of a competitive segment and acquiring information to benefit the competitive segment.⁴² SJI management's interpretation of the Affiliate Standards is that it is permissible for an employee of one competitive business segment (in this case, the ASB) to market services of another competitive business segment (SJE).⁴³

During the audit period, the ASB was part of the regulated utility, SJG. ASB employees were SJG employees. We are not aware of any exception to the Affiliate Standards that permits utility employees performing competitive services to assist a competitive business segment of the utility. As a result, we believe the "Community Rewards" and "In-Home Brochure" programs as implemented to be out of compliance with Affiliate Standards. In addition, we believe providing rewards to SJG employees (whether working for the ASB or for the regulated utility) to solicit business for SJE clouds the distinction between SJE and SJG in the minds of customers.

4. Telemarketing

According to at least one management employee, telemarketing was the marketing program primarily responsible for increasing the number of residential customers from approximately 30,000 to 70,000 during the past year. During the audit period, telemarketing services were performed by a third party on behalf of SJE.

Affiliate Standards require specific disclaimers related to advertising and marketing materials (including electronic marketing, such as telemarketing). These disclaimers include a statement that the related competitive business segment of the public utility holding company (PUHC) "is not the same company as SJG, the gas public utility", the related competitive business segment of the PUHC is not regulated by the BPU and "you do not have to buy SJE's products in order to continue to receive quality regulated services from the gas public utility."⁴⁴ It is our understanding that these disclaimers in quotations above are not subject to modification.

A review of the one telemarketing script provided to us indicates that the only attempt to distinguish SJE from SJG was a brief comment in the middle of the marketing pitch that SJE was "... not the utility company, but an affiliated supplier ...".⁴⁵ In our opinion, such a comment reinforces the relationship between SJE and the regulated utility, SJG, rather than conveying a message that the two entities are distinct and separate. The same might be true if the required language by the BPU was used. In any event, SJG chose not to make the proper disclaimers in its telemarketing efforts and, as a result, did not comply with the Affiliate Standards.

⁴² Affiliate Standard 14:4-5.3(m)1-3.

⁴³ Interview notes: Edward Graham, December 18, 2002 (No. 19).

⁴⁴ Affiliate Standard 14:4-5.4(k)1-3.

⁴⁵ OC-119.

5. Utility and Corporate Brand Association

SJE's association with SJG provides it with a clear competitive advantage over smaller, lesser-known gas marketers. Management clearly recognizes this as evidenced by the following:

- a. Common Logo - In 2000, SJI worked with its outside advertising agency to create a new logo for the company. An excerpt from the SJI Today newsletter sums up the purpose of the new logo⁴⁶:

The motivation behind the logo was to develop a symbol that when combined with SJI, or SJG, or SJE, would transfer equity from one company to the other. . . 'We wanted consumers to make the connection between SJI's companies so we could capitalize on their positive feelings,' [SJG President, Charles] Bisciegliia said. . . After several designs, SJI chose the three-tiered, tri-colored flame design. 'By using three colors and one symbol, we've been able to establish a single identity that transfers to each company,' explained Bisciegliia. 'Each segment represents a company -- orange for SJI, blue for SJG, and yellow for SJE.'

- b. Brand Positioning - Management acknowledged that ". . . the strongest customer and key public connections / recognition is with South Jersey Gas Company, . . . [and] a near-term goal for senior management is to position these brands [SJG, SJE, and SJI] so that key public see them as one and the same."⁴⁷

We believe that SJE's association with the utility is a significant competitive advantage. Without it, customers would be much less likely to leave the comfort of doing business with the utility and to enter into long-term contracts with an unfamiliar entrant into the gas marketing business.

D. Inter-company Services, Transfer Pricing, and Cost Allocations

1. Financial Results

The financial results of SJE are summarized in the following table for the twelve-month period ending December 31, 2001 and the nine-month period ending September 30, 2002:

SJG asserts that the following table includes confidential information.

⁴⁶ OC-28 (Issue 3, 5/5/00).

⁴⁷ OC-32 (SJI Strategic Planning Report (dated March 2000)), p. F-1.

Table 6-2 SJE - Consolidated Summary of Financial Results		
Description	12 Months Ended 12/31/01	9 Months Ended 9/30/02
Operating Revenues	Redacted	Redacted
Operating Expenses	Redacted	Redacted
Operating Income	Redacted	Redacted
Other Income:		
Equity in SJES	Redacted	Redacted
Equity in AirLogics	Redacted	Redacted
SJET Equity in SJRG	Redacted	Redacted
Interest and Other	Redacted	Redacted
Total	Redacted	Redacted
Income Tax Expense	Redacted	Redacted
Discontinued Operations	Redacted	Redacted
Net Income	Redacted	Redacted
Sources: OC-20, OC-79, and OC-116		

2. Cross Subsidization

A fundamental test of whether SJG is subsidizing SJE is whether SJE's prices are high enough to recover fully-allocated costs (i.e., whether SJE earns a profit). As can be seen in the preceding table, SJE recorded a profit during the audit period.

Having determined SJE's prices are high enough to cover its *recorded* costs, it is necessary to turn to the question of whether its recorded costs reflected its total *economic* costs. With respect to this, we can make the following observations:

- SJE's costs do not include a share of the fixed costs associated with the duty to serve that SJG, as supplier of last resort, must incur. Primarily these include the fixed costs of capacity necessary to meet peaking requirements incurred by SJG but not by other market participants. We did not attempt to quantify these costs, as it was beyond the scope of the audit. SJG's shouldering of all duty-to-serve costs amounts to a cross-subsidization of all non-utility competitive market participants. Since the existence of these costs was common knowledge when competition was established, it appears this result was intended. Without a detailed study of SJG's gas supply costs, it is impossible to know whether SJE's share of duty-to-serve costs would be sufficient, by itself, to eliminate SJE's recorded profit.

We lack sufficient information to determine the extent to which this cross-subsidy is likely to affect SJE's prices or the prices of other competitive market participants. However, it can be stated that allocating duty-to-serve costs to non-utility competitors would lower the gas cost that SJG passes through to customers in its LGAC. A lower LGAC would tighten (and perhaps eliminate) the cost differential between SJG and SJE,

constraining SJE's ability to pass its duty-to-serve costs along to customers. This would most likely affect SJE's profit margin, which might shrink enough to cause SJE to exit the retail gas commodity market altogether.

- Included in SJE's costs are allocations of shared corporate and utility services. As noted in Chapter 3, many of these costs were not properly supported, so we were unable to determine whether SJE received a proper share of these costs. We do not believe that SJE's unallocated share of these costs is sufficient, by itself, to eliminate SJE's profit. To the extent that SJG's allocated share of shared corporate costs is higher because allocations to SJE are insufficient, SJG has cross-subsidized SJE.

3. Products and Services Provided by SJE to SJG

As part of its energy management services, SJE was hired by SJG to retro-fit lighting fixtures, replace and/or improve an HVAC system, and upgrade the perimeter hot water heating system of several of SJG's facilities over the past four years. The total price for all projects disclosed to us exceeded \$1,100,000. Based on the dates the contracts were signed, most of this work took place prior to the audit period.⁴⁸ We only noted \$2,500 paid by SJG to SJE for this type of work in 2001 or the first nine months of 2002.⁴⁹ Given the immaterial amounts involved during the audit period, we did no further testing of the pricing between SJG and SJE.

We were not made aware of any sales of gas commodity from SJE to SJG during the audit period. However, since management believes that sales from SJE to SJG are not required to be eliminated for purposes of presenting SJI consolidated income statements (based on an interpretation of Statement of Financial Accounting Standards No. 71), we were unable to independently test whether such sales had taken place.⁵⁰

4. Products and Services Provided by SJG to SJE

As discussed in Chapter 3, shared corporate service functions performed by employees assigned to SJG were provided to SJE during the audit period. For the twelve months ended December 31, 2001 and the nine months ended September 30, 2002, SJG directly billed SJE for \$303,381 and \$280,485, respectively. SJG also directly billed EnerTrade for an additional \$9,574 and \$5,692 during the same time periods.⁵¹ SJG employee time was also charged to SJI and then charged to SJE through secondary allocations in the form of the management service fee and the corporate and fiscal charges. SJE's allocation of these charges during the audit period only totaled \$73,987.

⁴⁸ OC-17 (Lighting retro-fit - \$169,196; lighting retro-fit - \$118,256; HVAC - \$497,000; HVAC Phase II - \$360,000; and perimeter hot water heating system - \$35,000).

⁴⁹ OC-11.

⁵⁰ OC-79.

⁵¹ OC-11 (not adjusted for manual corrections made to the face of the bill).

We believe that the allocations of shared corporate functions to SJE were understated for the reasons specified in Chapter 3. However, we were unable to quantify all potential understatements of costs due to the limited information provided by SJG.

SJE was billed by SJG for shared utility functions. During the audit period, this primarily consisted of the customer account services that were billed by SJG at \$0.075 per bill.⁵² The derivation of this rate was not properly supported.

SJG also sold gas to SJE and EnerTrade during the audit period. For the twelve months ended December 31, 2001 and the nine months ended September 30, 2002, these transactions totaled \$7,184,365 and \$6,383,588, respectively.⁵³ These inter-company transactions represented 1.5% and 2.4%, respectively, of all SJG revenues during these time periods. SJG represented to us and the BPU (by not filing a required report) that no affiliate discounts occurred during the audit period.⁵⁴

E. Employees Transferred to / from SJE

Management represented that one employee transferred from SJG to SJE (Marlene Macri), and one employee transferred from SJE to SJG (Robert Barbieri) in 2002.⁵⁵ Since SJI was unable to provide employee listings from prior years, we were unable to test this representation. To our knowledge, the report filed with the BPU regarding employee transfers has not yet been filed for calendar year 2002.

F. Additional Information

At the request of BPU staff, we have acquired the following information concerning the sales volumes by customer class for SJE in 2001 and 2002:

SJG asserts that the following table includes confidential information.

⁵² Beginning in September, 2002, the price will increase to \$0.30 per bill to reflect SJG's purchase of receivables.

⁵³ OC-79 (Based on the assumption that all SJG sales of gas to SJE had to be eliminated.)

⁵⁴ OC-17.

⁵⁵ OC-27.

Table 6-3 SJE Sales Volumes by Customer Class (in DTs)		
Customer Class	12 Months Ended 12/31/01	12 Months Ended 12/31/02
Residential	Redacted	Redacted
Commercial	Redacted	Redacted
Industrial	Redacted	Redacted
Total	Redacted	Redacted
Source: OC-125		

Appendix 1 - Interview List

South Jersey Industries Interview List			
Date	Interviewee	Interviewer	Subject/Topic
10/8/02	Richard Walker	Robert Welchlin, Gregory Oetting	Organizational Overview
10/9/02	David Kindlick	Robert Welchlin, Gregory Oetting	Affiliate Standards Compliance and Related Issues
10/10/02	Albert Ruggiero	Gregory Oetting	Millennium, Communication Plan, Information Transfers, Advanced Research Data Used by Appliance Service Business
10/10/02	Thomas Kavanaugh	Gregory Oetting	Cost Allocations and Intercompany Accounting
10/29/02	Robert Fatzinger	Gregory Oetting	Appliance Service Business
10/30/02	Patrick Finnigan	Gregory Oetting	Information Technology
10/30/02	Bonnie Bornstein	Gregory Oetting	Customer Service
10/31/02	Richard Walker, Albert Ruggiero, David Kindlick	Robert Welchlin, Gregory Oetting, Andrew Miller	Executive Management Presentation
11/1/02	Bonnie Bornstein	Gregory Oetting, Andrew Miller	Customer Service System Demonstration
11/1/02	Thomas Kavanaugh	Robert Welchlin, Gregory Oetting, Andrew Miller	Cost Allocations and Intercompany Accounting
11/20/02	Paul Straub	Gregory Oetting, Andrew Miller	Financial Planning and Internal Accounting Reporting
11/20/02	Joseph Scaffidi, Albert Ruggiero	Gregory Oetting, Andrew Miller	Millennium
11/21/02	David Robbins	Gregory Oetting, Andrew Miller	Accounting for Non-regulated Business
11/22/02	Joseph Scheufele	Gregory Oetting, Andrew Miller	Marketing and Planning
12/12/02	Sharon Pennington	Gregory Oetting	Human Resources
12/13/02	Richard Walker	Robert Welchlin, Gregory Oetting	Internal Audit, Millennium, Board Actions, Risk Management
12/17/02	Michael Renna	Robert Welchlin, Gregory Oetting	Non-regulated Businesses
12/18/02	Jeffrey DuBois	Robert Welchlin, Gregory Oetting	Gas Supply
12/18/02	Edward Graham	Robert Welchlin, Gregory Oetting	SJI, SJE, SJRG, Marina
12/19/02	Patrick Finnigan	Gregory Oetting	Information Technology
12/20/02	Jeffrey DuBois	Gregory Oetting	Physical and Options Tracking and Risk Management
01/10/03	Thomas Kavanaugh, David Robbins	Gregory Oetting, Andrew Miller	
01/14/03	Thomas Kavanaugh	Gregory Oetting, Andrew Miller	

Appendix 2 - Data Log

**South Jersey Gas
DATA LOG OF OVERLAND CONSULTING
ON BEHALF OF THE NEW JERSEY BPU**

Resp.	Dr No.	Date Sent	Date Received	Description	Elapsed Days
C	OC 1	7/30/02	9/18/02	<p>Accounting / Chart of Accounts Please provide a copy of South Jersey Gas' and South Jersey Industries' current chart of accounts and accounting codes. Include keys to the Company's account coding block and all financial and management codes used to classify costs as to type, source, and departmental responsibility. Please also provide any previous versions of the chart of accounts that were in effect at any point since January 2000. If possible, please provide this information in electronic form.</p> <p><i>9/18/02--Complete--Received copies (hard copy formats) of SJG's and SJI's charts of accounts. SJG uses the FERC chart of accounts (a copy of the FERC accounts was provided). A list of SJG divisions was provided.</i></p>	50
C	OC 2	7/30/02	9/18/02	<p>Accounting / Procedures Please provide copies of the following accounting procedures effective during the period 2000 through the present:</p> <ol style="list-style-type: none"> 1. South Jersey Industries corporate cost allocation procedures describing allocation methodologies, cost pools, allocation factors and the use of allocation vs. direct assignment. 2. Timekeeping procedures used by employees performing competitive services and employees whose costs are charged to other subsidiaries (e.g. holding company employees). 3. Transfer pricing procedures applicable to pricing of inter-company services. 4. Fully distributed cost procedures applicable to pricing of competitive services. <p><i>1/29/03--Update--Received additional timekeeping procedure information. 9/18/02--Complete--Received a copy of SJI's Cost Allocation Manual. The Manual addresses points 1 through 4.</i></p>	50

Resp.	Dr No.	Date Sent	Date Received	Description	Elapsed Days
C	OC 3	7/30/02	10/22/02	Accounting / Policies Please provide a listing or index of all South Jersey Industries and South Jersey Gas written accounting policies and standard practices in effect during the period January, 2000 to present. <i>9/18/02--Partial--Received an index of SJI and SJG accounting policies and practices. (Appears to be missing basic procedures such as capital vs. expense, employee expense reimb, month end and year end accruals, etc. Per discussion with Rick Walker on 10/11/02, a list of the whole company's procedures will be provided in the future.) 10/22/02: Complete. Provided an index to the Operating Procedures Manual. Still appears to be incomplete (e.g. capitalization policy, disbursement authorization levels, etc.) but will follow up with interview questions or DR's.</i>	84
C	OC 4	7/30/02	10/10/02	Regulatory Filings / NJBPU Please provide a copy of South Jersey Gas' New Jersey BPU filings, in electronic format if possible, for 2000 through 2002. <i>10/10/02 - Complete. Received in field. Received a listing of all filings made with the BPU from 2000 to 2002. Due to the voluminous nature of the filings, they will be available for review on the premises. However, the company did provide a copy of the petition and associated attachments for the transfer of the Appliance Service Business.</i>	72
C	OC 5	7/30/02	9/18/02	Prior Audit / Implementation Plans Please provide copies of any implementation plans related to recommendations from the prior compliance audit done by Schumaker & Co. <i>9/18/02--Complete--Received SJI's/SJG's implementation plans for the Schumaker & Co. audit recommendations. (NEED TO CHECK TO SEE IF WE HAVE COPY OF RECOMMENDATION VI-6. IT SEEMS TO BE MISSING FROM COPY IN FIELD.)</i>	50
C	OC 6	7/30/02	10/11/02	Fin Data / Budget Roll Up Please provide a chart that shows the roll up of South Jersey Gas and other South Jersey Industries subsidiary department budget responsibility centers through the management structure (e.g. managers, directors, vice presidents, CEO). Include the title of each responsibility center as of January 2001, January 2002, and current. <i>10/11/02 - Complete. Received in field. Received a short list of responsible managers for SJG's affiliates and a handful of employee for various SJG functions. SJG does not have a management accounting system that segregates costs by cost center, responsibility center, or departments. Instead, SJG assigns responsibility of costs by function which mirrors the FERC chart of accounts.</i>	73

Resp.	Dr No.	Date Sent	Date Received	Description	Elapsed Days
C	OC 7	7/30/02	10/8/02	Accounting / Cost Allocation Data For fiscal years 2000, 2001, and 2002 to date, please provide, in electronic spreadsheet form if possible, the South Jersey Industries corporate cost allocation model showing allocations among subsidiaries and underlying allocation formulas. <i>10/8/02 - Complete - Received in field. Received a hard-copy summary of intercompany transactions for 1) SJL to SJG and 2) SJG to all other affiliates. Cover sheet references methodologies and formulas provided in response to OC-2.</i>	70
C	OC 8	7/30/02	9/18/02	Regulatory Filings / FERC Please provide a copy of South Jersey Gas' FERC filings, in electronic format if possible, for 2000 through 2002. <i>9/18/02--Complete--Received copies of motions filed with the FERC since January, 2000.</i>	50
C	OC 9	7/30/02	10/10/02	Competitive Services / Listing For fiscal years 2001 and 2002, please provide a list of all products and services, (other than regulated, tariffed, utility services) provided by South Jersey Industries subsidiaries to third parties. For each service, please indicate whether South Jersey Industries / South Jersey Gas classifies the service or product as "competitive" under the BPU's Energy Competition Standards, Subchapter 5, Affiliate Relations, Fair Competition and Accounting Standards and Related Reporting Requirements. <i>10/10/02 - Complete. Received listing in field.</i>	72
C	OC 10	7/30/02	9/18/02	Affiliate / Product & Service Descriptions For each affiliate transacting business with South Jersey Gas in fiscal years 2001 and 2002, please provide a list of the products and services provided: 1. By South Jersey Gas to affiliates 2. By affiliates to South Jersey Gas. Please include a brief description of each product or service to the extent it is not self-explanatory. <i>9/18/02--Complete--The list of products and services provided by SJG to affiliates and affiliates to SJG is included in the Manual provided in OC-2. The response to OC-10 also provides a supplemental list of other intra-company products and services not in the Manual. Informataion in CAM is not easily translated into a response to this question. (Per Rick Walker, the reference in the response should have included OC-7.)</i>	50

Resp.	Dr No.	Date Sent	Date Received	Description	Elapsed Days
P	OC 11	7/30/02		Affiliate / Invoices Please provide, in electronic format if available: 1. A copy of all affiliate transaction invoices or statements for intra-company billings to and from South Jersey Gas and affiliates for fiscal years 2001 and 2002. 2. Data used to develop or which supports the amounts on the invoices or statements. <i>1/15/03--Update--Received additional invoices, including SJG to Millennium, SJG to SJI, SJI to SJG, SJG to SJE, and MSI to SJG. 12/27/02--Partial--Received 2001 and 2002 invoices: SJG to SJRG and SJRG to SJG. It is difficult to tell if all needed invoices were provided. Still need the following data: all SJE invoices to SJG from 2001 and 2002 and any additional MSI invoices to SJG from 2001 and 2002 (beyond Aug to Dec 2001 invoices already provided). 12/13/02--Partial--Received the following data: 2001 SJI to SJG invoice, July and Sept 2002 SJG invoices, miscellaneous SJI invoices to SJG, MSI invoices to SJG (Aug to Dec 2001), and Millennium invoices to SJG for 2000 and 2001. Still need the following data: all SJE invoices to SJG from 2001 and 2002, all SJG invoices to SJRG and SJRG invoices to SJG from 2001 and 2002 (to account for elimination entries on consolidating financial statements), and any additional MSI invoices to SJG from 2001 and 2002 (beyond Aug to Dec 2001 invoices already provided). 10/22/02: Partial. Still missing Jan 2001 SJI invoice to SJG, Jul 2002 SJG invoices to all affiliates, Sep 2002 SJG invoices to all affiliates, Millennium invoices to SJG, and SJE invoices to SJG, Measurement Solutions invoices to SJG, and all miscellaneous invoices from SJI to SJG (director fees, 401(k), etc.). 9/18/02--Nearly complete--Received hard copies of affiliate transaction invoices from SJI to affiliates (including SJG) and from SJG to affiliates for fiscal years 2001 and 2002 to date. Still need any data used to support the invoiced amounts. If no support is available, please indicate so. Invoices seem to start in the middle of 2001 and end in the middle of 2002. Need all invoices from 2001 and the remaining 2002 as they become available.</i>	226
C	OC 12	7/30/02	9/18/02	Affiliate / Other Transactions For fiscal years 2001 and 2002, please provide a list and brief description of inter-company transactions between South Jersey Gas and its parent company or affiliates that do not involve the exchange of identifiable goods or services (e.g. financial transactions involving intercompany loans or dividends, management fees, tax allocation transactions, etc.) <i>9/18/02--Complete--The list of inter-company transactions not involving goods and services is included in the Manual provided in OC-2. The response to OC-12 also provides a supplemental list/description of other inter-company transactions not described in the Manual.</i>	50

Resp.	Dr No.	Date Sent	Date Received	Description	Elapsed Days
C	OC 13	7/30/02	12/27/02	Org Charts / Management Please provide copies of management organization charts showing the job titles and South Jersey Industries subsidiary designations in effect for 2000 through present for the following units: South Jersey Industries South Jersey Gas South Jersey Energy and subsidiaries South Jersey Resources Group and subsidiaries Marina Energy LLC <i>12/27/02--Complete--Received a listing of the officers and employees (of SJG) that work on SJRG matters and a listing of the officers of Marina. The Company stated that because these affiliates do not actually have their own employees, no organizational charts exist. Consider complete. 9/18/02--Partial--Received org charts for SJI, SJG, and various other affiliates. No org charts received for SJRG and Marina for any year.</i>	150
C	OC 14	7/30/02	10/8/02	BPU / Compliance Plans Please provide copies of South Jersey Gas' "compliance plans" for complying with BPU Energy Competition Standards in effect since the beginning of 2000. <i>2/26/03--Update--Received the Company's most recent Compliance Plan filed with the BPU on 2/25/03. 10/8/02 - Complete - Received in field.</i>	70
C	OC 15	7/30/02	9/18/02	Accounting / Reports Please provide a list of recurring management and financial accounting reports available from the South Jersey Industries and South Jersey Gas financial systems. <i>9/18/02--Complete--Received a list of management and financial accounting reports for both SJI and SJG.</i>	50

Resp.	Dr No.	Date Sent	Date Received	Description	Elapsed Days
C	OC 16	7/30/02	1/10/03	<p>Org Charts / Legal Entities</p> <p>Please provide copies of South Jersey Industries legal organization charts showing all subsidiaries and ownership relationships for the years 2000 through present. Please indicate the following for each subsidiary:</p> <ol style="list-style-type: none"> 1. whether consolidated into South Jersey Industries for accounting 2. percentage ownership 3. whether operating or non-operating 4. number of employees <p><i>1/10/03--Complete pending review--Received clarification that the org charts provided by the Company were in fact SJI's structure for the entire period under audit. 12/27/02--Partial--Received follow-up that is non-responsive. Overland requested clarification of what time period the organizational charts relate to but received the incorporation dates of the Company's affiliates. The Company needs to state that the organizational charts provided represent the Company's structure during the period under audit, if in fact that is the case. 9/18/02--Partial--Received a legal org chart and a narrative explanation that describes the consolidation process, ownership, operating nature, and number of employees. Upon further review, need a clarification that the org chart provided covers the entire time period requested. The org chart is dated 4/19/01.</i></p>	164
C	OC 17	7/30/02	12/27/02	<p>BPU / Required Filings Re: Affiliates</p> <p>Please provide, for the period January, 2000 to present, copies of the following records required by the BPU's Affiliate Relations, Fair Competition and Accounting Standards and Related Reporting Requirements:</p> <ol style="list-style-type: none"> 1. "Affiliate Discount Reports" that South Jersey Gas has filed since January, 2000 (see 14:4-5.3 (g)) 2. Records of contracts and related bids between South Jersey Gas and South Jersey Industries or competitive services affiliates. (see 14:4-5.4 (k)) 3. Reports of utility / affiliate employee transfers (see 14:4-5.5 (r) (2)) <p><i>12/27/02--Complete--Received signed and dated "final" contracts. All contracts are dated July 1, 2002. Consider complete. 10/11/02 - Partial. Received several unsigned, un-dated contracts between various parties. Need to supply signed and dated "final" contracts.</i></p>	150
C	OC 18	7/30/02	9/18/02	<p>Affiliate / Financial Statements</p> <p>For the years 2000 and 2001, please provide financial statements for each South Jersey Industries affiliate that maintains separate books.</p> <p><i>9/18/02--Complete--Received 2000 and 2001 financial statements.</i></p>	50

Resp.	Dr No.	Date Sent	Date Received	Description	Elapsed Days
C	OC 19	7/30/02	10/8/02	Competitive Services / Procedures Please provide copies of any South Jersey Gas, South Jersey Industries, or South Jersey Industries subsidiary written policies or procedures addressing the following subjects: <ol style="list-style-type: none"> 1. Joint corporate support services (utility and affiliate) 2. Joint use of computer systems and related controls to ensure separation of data access 3. Joint marketing, advertising, promotion services 4. Employee transfers and employee loans or sharing 5. Sharing / provision of utility non-customer, non-public proprietary data to affiliates 6. Sharing / provision of utility customer data to affiliates 7. Separation of utility and affiliate employees and board members 8. Procedures to be used by utility customer service and marketing personnel relating to provision of competitive services information to customers <i>10/8/02--Complete pending review-- Received an additional response in the field addressing Items 2, 5, 6, and 8. Company says responses for Items 3, 4, or 7 is available in their Compliance Plan and Cost Allocation Manual. 9/18/02--Partial--Received a response referring to the response to OC-2 (Cost Allocation Manual) for part 1. Need information for the remaining parts to this request.</i>	70

Resp.	Dr No.	Date Sent	Date Received	Description	Elapsed Days
C/NR	OC 20	9/25/02	1/6/03	<p>Fin Data / Trial Balances</p> <p>Please provide, in electronic format, business unit ("divisional") level trial balances for all SJI affiliates for fiscal years 2000, 2001 and 2002 (through the third quarter). Please update 2002 for the complete fiscal year when available.</p> <p><i>1/6/03--Complete/Non-responsive--OC-20 is complete/non-responsive because Overland never received 2000 or 2001 Millennium TB's. 12/27/02--Partial--Still need Millenium TB's. Received the following trial balances (or equivalent) in hard copy format: SJ Fuel, EnerTrade, R + T Group, and Energy and Minerals, SJRG, AirLogics, and SJES (2000), monthly budget variance financial statements for Millennium (2000-2002 w/ a few months' exception)), trial balances from November 2001 to September 2002 for Marina (all available according to the Company), and an expanation that no MSI data is available. 12/5/02--Update/Still Partial--Received the following trial balances in hard copy format: SJI (2000, 2001, and 2002 through Sep), SJE (2000, 2001, and 2002 through Sep), SJ Fuel, EnerTrade, R+T Group, Energy and Minerals, SJRG, AirLogics, and SJES (2001 and 2002 through Oct). Still need the following data: 2000 and 2001 Millennium data, 2000 data for SJ Fuel, EnerTrade, R+T Group, Energy and Minerals, SJRG, AirLogics, and SJES, 2000, 2001, and 2002 data for Marina Energy and MSI. When available, also need 2002 through year-end. 11/18/02--Update--as of this date, we have SJI (hard copy), SJE (hard copy), and Millennium (electronic) trial balances for 2002. We do not have trial balances from any other affiliates (including SJG). We do not have any trial balances for 2000 or 2001. 11/15/02--Received Millennium trial balances for 2002. The trial balances require reformatting by Overland to perform analysis. Still need 2000 and 2001 trial balances for all affiliates, including Millennium. 10/24/02: Non-Responsive. Received hard copies of SJ Industries' TB and SJ Energy's TB for 2002 only. Stated that SJ Gas TB does not exist. Company should provide all affiliates' TB's that exist electronically.</i></p>	103

Resp.	Dr No.	Date Sent	Date Received	Description	Elapsed Days
C	OC 21	9/25/02	12/27/02	Fin Data / Budget Variance Reports Please provide, for fiscal years 2000, 2001, and 2002 to date, copies of budget variance reports (monthly and YTD financial statement comparisons to PY and budget) at the most detailed level possible. <i>12/27/02--Complete pending review--Received the following data: an explanation that no additional SJRG data exists for 2000 or 2001, SJES, AirLogics, and Marina 2000, 2001, and 2002 variances to date, and Energy and Minerals, SJRG, EnerTrade, SJ Fuels, and R+T Group 2002 variances to date. Received most budget variance reports for Millenium in response to OC-20. Apparently, no MSI TB is prepared given the nature of the immaterial investment. Per response to OC-20, this data may not be available or was provided in response to OC-20. 12/12/02--Partial--Received the following data: SJG 2000, SJE, SJ EnerTrade, SJI, SJ Fuel, R&T Group, Energy & Minerals 2000 and 2001, and 2001 (April through Dec) SJRG. Still need the following: A) 2002 for all entities (other than SJI, SJG, and SJE--these are complete), B) 2000, 2001, and 2002 (as indicated in part A) for SJES, AirLogics, Millennium, Marina Energy, and MSI, and C) 2000, remaining 2001 (January to March) and 2002 (as indicated in part A) for SJRG. 11/18/02--Partial--Received SJI and SJE statements for 2002 (January through September). 2000 and 2001 data not provided. 10/22/02: Partial. Provided SJG internal financial statements for 2001 and Jan-Sep 2002. 2000 data not provided.</i>	93
C	OC 22	9/25/02	10/22/02	BPU / Advice Letters Please provide copies of SJI / SJG advice letters filed by SJI with the BPU concerning approvals related to affiliates or competitive services since the interim affiliate standards were effective in 2000. <i>10/22/02: Complete. None requested or filed per SJG.</i>	27
C	OC 23	9/25/02	10/22/02	Internal Audit / Listing Please provide a list of internal audits completed since the beginning of fiscal year 2000. <i>10/22/02: Complete.</i>	27
C	OC 24	9/25/02	10/22/02	Internal Audit / Risk Assessment Please provide a copy of the SJI internal audit department's audit risk assessments for fiscal years 2000, 2001 and 2002. <i>10/22/02: Complete. Internal Auditing Department Audit Plans provided for 2000, 2001, and 2002.</i>	27

Resp.	Dr No.	Date Sent	Date Received	Description	Elapsed Days
C/NR	OC 25	9/25/02	1/10/03	<p>Employee List Please provide a list of SJI and subsidiary employees with affiliate (SJG, SJ Energy, etc), division, and any other (more detailed) designations as of 12/31/00, 12/31/01, and 9/30/02.</p> <p>10/31/02--Modified request--asked for an updated list with location and management responsibility (who each employee reports to) information in electronic form.</p> <p><i>1/10/03--Complete/Non-responsive--The Company verified that the electronic data is from 2002 (as of 10/18/02). However, the Company is not able to provide 2000 or 2001 employee counts. Management responsibility information was also not provided. 11/15/02--Partial--Received an Excel spreadsheet with employee data. It is not clear what the effective date for the employee list may be. It appears it represents only one point in time, not the three points in time requested. The list does not provide management responsibility information. 10/24/02: Partial. A hard copy of an employee list was provided. However, it is not clear when the employee list is effective (probably 10/18/02) and does not provide data for 3 separate points in time as requested.</i></p>	107
C	OC 26	9/25/02	10/24/02	<p>Policies and Procedures / Procurement Please provide a copy of SJI procurement / purchasing procedures in effect since the beginning of fiscal year 2000.</p> <p><i>10/24/02: Complete. Policy dated 1/22/96 provided.</i></p>	29
C	OC 27	9/25/02	10/29/02	<p>Employee Transfers Please provide:</p> <p>1. A list of employees transferred between SJG and other affiliates (including the appliance services business) from the beginning of fiscal year 2000 through the present. Please update this list as necessary through the end of fiscal year 2002. On this list, please provide:</p> <p>Employee name Transferred from Business Unit Transferred from Job Title Transferred to Business Unit Transferred to Job Title Transfer date</p> <p>2. For each applicable transfer, identify any payments made by the acquiring affiliate to the affiliate from which the employee transferred and indicate the basis for the payment (i.e. pct of salary, etc.).</p> <p><i>10/29/02--Complete--Received a list of employee transfers for the period requested.</i></p>	34

Resp.	Dr No.	Date Sent	Date Received	Description	Elapsed Days
C	OC 28	9/25/02	11/18/02	Employee Newsletters Please provide copies of SJI and/or SJG newsletters and employee publications for the period January, 2000 through the present. <i>11/18/02--Complete pending review--Received missing issues from 2000 and explanations regarding the other issues listed below. 10/22/02: Partial. Missing the following SJI Today newsletters: possibly Issue 1 in 2000 (is 1999 newsletter mis-dated?), Issue 5 in 2000, Issue 7 in 2000, any issue between 9/6/00 and 2/21/01, Issue 5 in 2002, possibly Issue 1 in 2002, and Issue 20 in 2002.</i>	54
C	OC 29	9/25/02	11/18/02	Shared Svcs / Customer Service / Scripts Please provide copies of all sales, marketing, customer service, safety and other scripts, suggested language or suggested approaches to dealing with customers or answering customer questions applicable to customer service order / inquiry, field services (IM&R) or marketing employees effective since the beginning of fiscal year 2000. <i>11/18/02--Complete pending review--Received the Company's "General Customer Relations Guidelines." 10/22/02: Partial. Company says they do not use sripts. However, it does reference the "General Customer Relations Guidelines" (training manual) which were not provided. At a minimum, this needs to be provided to complete the answer.</i>	54
C	OC 30	9/25/02	12/12/02	Shared Svcs / Advertising Provide copy or scripts, as applicable, of all advertising placed in local media that involved SJG or competitive services affiliates during the period since the beginning of fiscal year 2000. <i>12/13/02--Update/Complete--Rick Walker confirmed that Overland received all advertising from SJI and its affiliates. Consider complete as of 12/12/02. 12/12/02--Complete pending review--Received confirmation of no SJG advertising in 2000 as well as what advertising was used for the other affiliates during 2000 to 2002. 10/22/02: Partial. Received 2001 and 2002 newspaper and radio scripts for SJG. Need to confirm that no advertising was done for SJG in 2000 AND no advertising was done for any of the other affiliates in 2000, 2001, and 2002 (appliance service business, SJ Energy, etc.)</i>	78

Resp.	Dr No.	Date Sent	Date Received	Description	Elapsed Days
C	OC 31	9/25/02	1/10/03	<p>Shared Svcs / Information Systems / Customer Data</p> <p>Provide the names of the information systems used to store customer records for sales, marketing, service provision/usage, billing or "care" purposes for the following businesses during the period from the beginning of fiscal year 2000 to the present:</p> <p>South Jersey Gas South Jersey Energy, including: SJ EnerTrade South Jersey Energy Solutions Airlogics R & T Group Energy & Minerals, including South Jersey Fuel Millennium Account Services Marina Energy South Jersey Resources</p> <p><i>1/10/03--Complete pending review--Received a follow-up regarding the SJRG affiliate's information systems. 12/12/02--Partial--Received response stating that no such systems exist at all of the listed affiliates (other than SJG). However, we are waiting for an amended response from SJI regarding its SJRG affiliate. 10/24/02: Partial. The response for several affiliates is "None - No such systems are linked to or support [sic] by South Jersey Gas Company." This is not a complete response to the question. Either these affiliate have no need for these systems, and as a result, they do not exist OR someone who does support the systems and knows the identity of them should answer the question.</i></p>	107
C	OC 32	9/25/02	10/24/02	<p>Business Plans / SJI SJG / 2000-2002</p> <p>Please provide copies of SJI and SJG business and / or strategic plans applicable to planning for fiscal years 2000, 2001 and 2002.</p> <p><i>12/5/02--Update--Received additional data for the Info Systems Service Plan. The data is the "completed" Business Line Service Matrix. 10/24/02: Complete. Provided the following: SJI Strategic Planning Staff Report (3/00), SJI Strategic Planning Staff Report (9/01 Update), SJG Customer Care Center 2001 Service Plan (5/01), SJG Info Systems 2001 Service Plan (5/01), SJG External Relations 2001 Service Plan (6/01), SJG Merchandising 2001 Business Plan (Update) (8/01), SJG Merchandising Exit Strategy Option Business Plan (9/01), SJG Merchandising Exit Plan (9/01), SJG Customer Care Center Preliminary 2002 Service Plan (8/01), SJG Info Systems Preliminary 2002 Service Plan (8/01), SJG External Relations Preliminary 2002 Service Plan (8/01), and SJG Appliance Service Preliminary 2002 Business Plan (8/01).</i></p>	29

Resp.	Dr No.	Date Sent	Date Received	Description	Elapsed Days
C	OC 33	9/25/02	10/22/02	Customer Service / Referrals Provide a list of SJG customers referred to affiliates for fiscal years 2000, 2001 and 2002 to date. (This excludes customers referred to the appliance business unit. It includes customers who may have been referred to South Jersey Energy and subs, Energy & Minerals, etc.) <i>10/22/02: Complete. Company states that no referrals occurred.</i>	27
C	OC 34	9/25/02	10/29/02	Policies and Procedures / Affiliate Standards Please provide copies of policies and procedures applicable to compliance with New Jersey BPU affiliate and competitive services standards not covered in data requests OC-2, OC-3, or OC-27. Please include copies of any policies and procedures involving the transfer or joint use of non-customer specific information between the gas utility and its affiliates, transfer or shared use of trademarks, logos, names, licenses and patents, transfer or shared use of employees, and transfer or shared use or proprietary or purchased / licensed software or information systems. <i>10/29/02--Complete pending review--According to the Company, the responses for OC-2, OC-19, and OC-26 provide the requested information.</i>	34
C	OC 35	9/25/02	10/22/02	Customers / Large Customer List Please provide a current list of SJG's 20 largest customers measured by gas volumes or revenue. (If available, a standard recurring sales report summarizing revenue, volumes and / or similar sales statistics by customer may be substituted for an ad hoc list applicable to precisely 20 customers.) <i>10/22/02: Complete. Received list based on last 12 reads.</i>	27
C	OC 36	9/25/02	10/22/02	Shared Svcs / Advertising / Bill Inserts Please provide copies of SJG customer bill inserts for fiscal years 2000, 2001 and 2002 to date. <i>10/22/02: Complete.</i>	27
C	OC 37	9/25/02	10/22/02	Shared Svcs / Customer Service / System Please make available / provide access to systems / files containing records of SJG customer requests and inquiries (service and repair orders and billing inquiries) for gas and appliance service, including requests for service initiation, repair and discontinuation for fiscal years 2001 and 2002 to date. <i>10/22/02: Complete. Access will be provided on-site at Overland's request.</i>	27

Resp.	Dr No.	Date Sent	Date Received	Description	Elapsed Days
C	OC 38	9/25/02	10/29/02	Affiliate / Contracts & Service Agreements Please provide a copy of any service agreements or contracts between SJG and other affiliates, as well as any agreements with SJL. <i>10/29/02--Complete pending review--Received various contracts/agreements (13) between SJL and SJG and SJG and other affiliates, such as administrative services agreements, a meter reading agreement, an equipment agreement, etc.</i>	34
C	OC 39	9/25/02	12/27/02	Accounting / Cost Allocation / Facilities Please provide all documentation to support the collection and assignment and / or allocation of facilities costs to affiliates for budget and regulatory jurisdictional segregation purposes. This should include copies of all building maps, leases, indexes, listings, spreadsheets, and other workpapers documentation containing information used to calculate fully allocated facilities costs and floorspace usage by affiliates. At a minimum, such documentation should show the usage of floorspace, measured in square feet, by affiliate, identify the cost per square foot, separately identify costs (in total and per square foot) for rent, maintenance, security, and utilities. It should include costs at any locations at which facilities costs are collected for budget and regulatory jurisdiction assignment / allocation to affiliates. Please provide all maps, documents or spreadsheets required to show the calculation of costs for each type of costs (I.e. rent vs. maintenance vs. utilities) and each location. To the extent the documentation exists in electronic form (I.e. spreadsheets), please provide in electronic form. <i>12/27/02--Complete pending review--Received an updated response providing the Company's most current facilities allocation data. Cost per square feet is given for seven different locations. A memo describes changes in space allocation for the new year. This data, along with what was provided earlier, satisfies the request. Consider complete.</i> <i>10/29/02--Partial--Received information covering the Folsom headquarters space and its usage as well as data for other facilities. It is not clear if the most current year data has been provided (some information is dated 2000 and some information is not dated). It is not clear if the space used by each of the Company's affiliates has been provided.</i>	93

Resp.	Dr No.	Date Sent	Date Received	Description	Elapsed Days
C/NR	OC 40	9/25/02	1/6/03	Accounting / GL Transactions Please provide a download, in electronic format, of all general ledger transactions, including all fields, for fiscal years 2000, 2001 and 2002 to date for SJG, the appliance business, and any other affiliates that roll into SJG or SJI for regulatory reporting purposes. <i>1/6/03--Complete/Non-responsive--OC-40 is complete/non-responsive because Overland did not receive Millennium G/L data for any of the years requested and the SJG electronic G/L data provided for all three years requested was not sent in a usable format. 12/27/02--Update/Partial--Received 2000 G/L data (electronically) from the following affiliates: SJI, SJE, EnerTrade, SJES, AirLogics, SJ Fuel, R+T Group, Energy and Minerals, and Marina. Also received 2001 and 2002 data for Marina. Still need SJRG, Millennium, and MSI data. 12/5/02--Update/Still Non-responsive--Received 2001 and 2002 G/L data (electronically) from the following affiliates: SJI, SJE, EnerTrade, SJES, AirLogics, SJRG, SJ Fuel, R+T Group, and Energy and Minerals. Still need 2000 data for all the entities listed above. Still need 2000, 2001, and 2002 data for Millennium, Marina Energy, and MSI. Received new SJG G/L data in a new electronic format for 2000, 2001, and 2002. The data is still not usable due to formatting problems. 11/15/02--Non-responsive--Received a zip file with Millennium data. It does not address this request. 10/22/02: Non-Responsive. Received 2 CD-ROMs with SJG data. Data as provided will take a significant amount of clean-up time (e.g., remove headers, etc.). Need to determine if another format is possible.</i>	103
C	OC 41	10/9/02	10/9/02	BPU / Compliance Plans / Communications Plan Please provide a copy of the "Communication Plan" referenced in the South Jersey Gas Company Compliance Plan. (This document was also mentioned in discussions with Rick Walker and Dave Kindlick on October 8 and 9.) <i>10/9/02 - Complete - Received information in field.</i>	0
C	OC 42	10/17/02	12/27/02	Fin Data / Rating Agency Reports For 2000, 2001, and 2002; please provide copies of all rating agency reports (S&P, Moody's, Mergent, etc.) for South Jersey Gas Company and any of its affiliates. <i>12/27/02--Complete--Received a response stating that the only formal written analysis from Moody's relates to a Summary Opinion dated 9/18/02. That data was provided with OC-85. An explanation of why the other data does not exist is also provided. Consider complete. 11/18/02--Partial--Received a Moody's ratings report dated 10/18/01. A search of the Moody's internet site indicates that additional information should be available to the company. 10/29/02--Non-responsive--Received a copy of a presentation made to Moody's on 10/10/02. The request actually asks for reports prepared by Moody's or S&P that provide rating information for SJI, SJG, or any other affiliates that are rated.</i>	71

Resp.	Dr No.	Date Sent	Date Received	Description	Elapsed Days
C	OC 43	10/17/02	10/31/02	Fin Data / Monthly Reports As discussed in the interview with Tom Kavanaugh on October 10, 2002; 1) Please provide a copy of the South Jersey Gas Company monthly internal financial statements for each month from January 2001 to present. If already provided in another response, please identify the response. 2) On the most recent South Jersey Gas Company monthly internal financial statement, please list the responsible person for each revenue and expense line item. If multiple persons are responsible for a particular line item, please identify each and every person and how the responsibility is divided. <i>11/18/02--Received an extra copy of the data that was already provided. 10/31/02--Complete-- Part 1: Referred to OC-21. Part 2: Received financial statements indicating the responsible person for each revenue and cost line.</i>	14
C/NR	OC 44	10/17/02	1/6/03	Accounting / General Ledgers As discussed in the interview with Tom Kavanaugh on October 10, 2002: 1) Please provide a copy of the general ledger for South Jersey Gas Company and all of its affiliates in electronic format for all of 2001 and 2002 (year-to-date). As with all requests, please update this request as additional information becomes available. (Note: In either year, a year-to-date general ledger can be substituted for separate monthly general ledgers as long as the information within each account is presented chronologically.) 2) Please provide a legend for all fields included in the electronic files provided in response to "1" above. <i>1/6/03--Complete/Non-responsive--See the rationale at OC-40. 12/5/02--Update/Still Non-responsive--Received new SJG data for 2000, 2001, and 2002 which is still not usable due to formatting problems. 11/25/02--Update--A satisfactory response to OC-40 will also address OC-44. 11/15/02--Non-responsive--Received a zip file containing multiple files. The files are supposed to address OC-20, 40, and 44 (for Millennium). The files do not address OC-44 (or OC-40).</i>	81

Resp.	Dr No.	Date Sent	Date Received	Description	Elapsed Days
C	OC45	10/17/02	11/4/02	Accounting / Cost Allocation / Payroll As discussed in the interview with Tom Kavanaugh on October 10, 2002: 1) Please provide a copy of the time allocation summary with associated time sheets for September 2002 for all employees of South Jersey Gas Company and its affiliates. 2) Please provide a copy of the payroll allocation model for September 2002 in electronic format. 3) Please document how the information presented in the time sheets, time allocation summary, and payroll allocation model provided above ties to the amounts recorded to the general ledger. <i>12/12/02--Complete--Rick Walker confirmed that all requested data was provided. Consider complete on 11/4/02. 11/4/02--Partial--Received time allocation summary and timesheets for September 2002 (not sure if it includes all employees) (part 1), the payroll allocation model (part 2), and a limited description of how the numbers tie to the general ledger (part 3). Need to confirm that all employees were provided.</i>	18
C	OC46	10/17/02	10/31/02	Fin Data / A&G Analysis As discussed in the interview with Tom Kavanaugh on October 10, 2002: 1) Please provide a copy of the monthly "A&G Analysis" for each month from January 2001 to present for South Jersey Gas Company and all of its affiliates. 2) Please provide a list of affiliates which do not prepare such an analysis and indicate how management specifically monitors their respective results. <i>10/31/02--Complete pending review--Received the monthly "A & G Analysis" for the period requested for SJG. No such reports are prepared for the other affiliates.</i>	14
C	OC47	10/17/02	10/31/02	Accounting / Management Service Fee As discussed in the interview with Tom Kavanaugh on October 10, 2002: For each month from January 2001 to present, provide the detailed components of the management service fee "cost pool" billed by South Jersey Industries to its subsidiaries. <i>11/18/02--Received additional data. Appears to be general ledger detail for specific accounts; it may relate to a different data request. 10/31/02--Complete--Received management service fee detail for the period requested.</i>	14

Resp.	Dr No.	Date Sent	Date Received	Description	Elapsed Days
C/NR	OC 48	10/17/02	12/27/02	<p>Affiliate / SJI / Summary of Affiliate Invoices</p> <p>As discussed in the interview with Tom Kavanaugh on October 10, 2002:</p> <p>Consistent with the information submitted in response to OC-7, please provide a summary of South Jersey Industries' billings to all affiliates from January 2001 to present. Each affiliate should be presented separately.</p> <p><i>12/27/02--Complete/Non-responsive--Received a response stating that the information requested is not available and that during a follow-up interview on November 1, 2002, it was agreed that alternate testing would provide the information requested here.</i></p>	71
C/NR	OC 49	10/17/02	12/19/02	<p>Accounting / Cost Allocation / Various Support</p> <p>As discussed in the interview with Tom Kavanaugh on October 10, 2002:</p> <p>1) Please provide in electronic format the:</p> <p>A) Journal Entry Edit B) Accounts Payable Schedule 33 C) and any other similar report for other sources of information (e.g., payroll, revenue, etc.)</p> <p>which shows the allocation of costs on the general ledger between South Jersey Gas Company and its affiliates. This data should be provided from January 2001 to present.</p> <p>(According to Tom, these reports are needed to view the distribution of costs to the various general ledger accounts for journal entries, vendor invoices, etc.)</p> <p>2) Please select a representative example on each report produced in response to "1" above and indicate how this information ties to the South Jersey Gas Company general ledger.</p> <p><i>12/19/02--Update--Consider Complete/Non-responsive. Data provided for Part 1, A is not responsive. 12/12/02--Partial/Non-responsive--Received a CD containing GL data addressing Part 1, A. The data is not in a format that can be used for meaningful analysis. The response indicates the data supplied for OC-40 also addresses OC-49. The data supplied for OC-40 is also unusable for analysis. Received an answer to Part 1, C. If the data is not available in any other electronic format, we will close the request and consider it "Complete/Non-responsive." 11/18/02--Partial--It appears we received the 2001 and 2002 A/P Schedule 33 (Part 1, B). Received other hard copy data. Unsure if it answers either Part 1, A or 1, C. Received an example for Question 2. Need to review.</i></p>	63

Resp.	Dr No.	Date Sent	Date Received	Description	Elapsed Days
C	OC 50	10/17/02	10/31/02	Prior Audit / Cost Allocation Matrix As discussed in the interview with Tom Kavanaugh on October 10, 2002: 1) Please provide a copy of the cost allocation matrix presented to the previous auditor, Schumaker & Company, Inc. <i>10/31/02--Complete--Received the cost allocation matrix presented to Schumaker & Company, Inc.</i>	14
C	OC 51	10/17/02	12/5/02	Accounting / Cost Allocation / Procedures As discussed in the interview with Tom Kavanaugh on October 10, 2002: Please identify any cost allocation procedure used during the time period from January 2001 to present that is not documented in the Cost Allocation Manual (CAM) produced in response to OC-2. In those cases, document the actual procedure employed and the time period in which the procedure was followed. <i>12/5/02--Complete pending review--Received listing of various cost allocation procedures supposedly not found in the CAM.</i>	49
C	OC 52	10/17/02	10/31/02	Fin Data / FERC Form 2's Please provide a copy of the FERC Form 2's filed by South Jersey Gas Company as of December 31, 2000 and December 31, 2001. <i>10/31/02--Complete--Received the 2000 and 2001 South Jersey Gas FERC Form 2's.</i>	14
C	OC 53	10/17/02	11/18/02	BPU / Communication Plan / Attendance Lists As mentioned in the Communication Plan provided in response to OC-41, please provide a copy of all meeting attendance lists of employees which occurred during 2001 or 2002 as referenced on p. 2 <i>11/18/02--Complete pending review--Received several lists for meetings and memo distribution.</i>	32

Resp.	Dr No.	Date Sent	Date Received	Description	Elapsed Days
C	OC 54	10/17/02	10/24/02	BPU / Communication Plan / Lists Referencing the Communication Plan provided in response to OC-41, 1) Please provide the most current list of natural gas suppliers maintained by the company (see p. 10). 2) Please provide the most current "residential shopping guide" maintained by the company (see p. 10). 3) Have either of these documents changed since they first were created? 4) If so, how many times have each of them changed in the past 12 months? <i>12/5/02--Update--Received additional data. 10/24/02: Complete.</i>	7
C	OC 55	10/17/02	11/18/02	Affiliate / Millennium / Various Questions In choosing to use Millennium Account Services, LLC (Millennium) to read meters for South Jersey Gas Company, 1) Did South Jersey Gas Company employ a competitive bidding process to make its selection of Millennium? 2) If so, please provide a copy of the bids that were rejected at the time that Millennium was initially selected and the "winning" Millennium bid. 3) If not, please explain in detail why South Jersey Gas did not believe that a competitive bidding process was necessary in purchasing services from a South Jersey Industries' joint venture. 4) Since Millennium's selection, has South Jersey Gas Company's meter reading work gone out for bid again? 5) If so, please provide a copy of all rejected bids from alternative service providers and the "winning" Millennium bid for each subsequent bidding process. 6) If not, how does South Jersey Gas Company's management ensure that it is not paying more than the fair market value of the service to Millennium? <i>11/18/02--Complete pending review--Received a response answering the requests' questions.</i>	32

Resp.	Dr No.	Date Sent	Date Received	Description	Elapsed Days
C	OC 56	10/17/02	12/31/02	Affiliate / Millennium / Various Questions In South Jersey Industries' 2001 Annual Report to Shareholders (p. 4), management indicates that Millennium Account Services, LLC (Millennium) earned pre-tax income of \$1.1 million. 1) Please confirm that Millennium's only customers in 2001 and 2002 were South Jersey Gas Company and a Connectiv affiliate. 2) How much of the \$1.1 million in 2001 pre-tax earnings are attributable to Millennium's business with South Jersey Gas Company? 3) What were Millennium's pre-tax earnings for the first 9 months of 2002? 4) How much of these 2002 pre-tax earnings were attributable to Millennium's business with South Jersey Gas Company? 5) Please identify the specific general ledger account that Millennium's billings to South Jersey Gas Company were recorded in 2001 and 2002. 12/31/02--Complete pending review--Received answers to Parts 1 through 5.	75
C	OC 57	10/17/02	12/5/02	Affiliate / Millennium / Service Contracts Please provide copies of all service contracts between Millennium Account Services, LLC and South Jersey Gas Company that have been in effect since January 1, 1999. 12/5/02--Complete pending review--Received two service contracts between Millennium and SJG.	49
P	OC 58	10/17/02		Affiliate / Millennium / Ownership Documents Please provide copies of all "ownership" documents concerning South Jersey Industries' interest in Millennium Account Services, LLC. At a minimum, the documents should indentify South Jersey Industries' share of the joint venture, rights to profits, responsibility for losses, and provision and distribution of capital. 12/5/02--Partial. Missing Appendices A, C, D, E, F, and G (at a minimum). Received the "Operating Agreement" between Millennium and SJI/Connectiv.	147

Resp.	Dr No.	Date Sent	Date Received	Description	Elapsed Days
C	OC 59	10/17/02	10/31/02	<p>Affiliate / Millennium / Distributions to SJI Regarding distributions from Millennium Account Services, LLC to South Jersey Industries since 1999 (according to Al Ruggiero, this has occurred at least twice):</p> <p>1) Please identify the date, entity, amount, and general ledger account numbers used to record the cash receipt. Provide supporting documents for this entry.</p> <p>2) Please indicate whether the cash receipt was "allocated" to South Jersey Gas Company.</p> <p>3) If so, please identify the date, entity, amount and general ledger account numbers used to record the allocation to South Jersey Gas Company -- both on South Jersey Industries' general ledger and on South Jersey Gas Company's general ledger. Provide supporting documents for these entries.</p> <p><i>10/31/02--Complete pending review--Received G/L activity data, cash summary data, and bank statements for (it appears) two distributions from Millennium to SJI.</i></p>	14
C	OC 60	10/17/02	12/27/02	<p>Risk Management Policy Please provide copies of all risk management policies of South Jersey Gas Company and its affiliates.</p> <p><i>12/27/02--Complete--Received the SJG Risk Management Policy. 12/19/02--Update/Partial--Still need the SJG Risk Management Policy. Per Rick Walker, this policy does exist and will be provided. 12/5/02--Complete pending review--Received an SJI risk management policy dated November 2002. Not sure if this is the ONLY policy for the Company.</i></p>	71
C	OC 61	10/17/02	12/27/02	<p>Affiliate / Officers and Directors Please provide the most current list of the officers and members of the board of directors for South Jersey Gas Company, all of its affiliates, and the Appliance Service Business. Please note the effective date that each person assumed his / her position.</p> <p><i>12/27/02--Complete pending review--Received a listing of the current officers and directors for SJI and its affiliates.</i></p>	71
C	OC 62	10/22/02	10/24/02	<p>Affiliate / ASB / Petition DR's & Responses Please provide a copy of all data requests and data responses related to South Jersey Gas Company's petition to separate the appliance service business into a newly created company. Please update this request as new data becomes available.</p> <p><i>10/24/02: Complete. Only 2 DR's asked to date (one involves the production of the CAM).</i></p>	2

Resp.	Dr No.	Date Sent	Date Received	Description	Elapsed Days
P	OC 63	11/1/02		Business Plans / SJE MAS SJRG ME / 2002-2003 Please provide the 2002 and 2003 business plans for all SJI affiliates for which they are available. If possible, provide plans for the following affiliates: South Jersey Energy Millennium Account Services South Jersey Resources Group Marina Energy <i>1/10/03--Still Partial--Received response stating the no 2002 SJRG plan exists. Company states that all 2003 plans are still in draft form, waiting for executive approval. Need 2003 plans when approved. 11/18/02--Partial--Received the following business plans: SJI Billing Services (2001 and 2002), SJE (2002), Millennium (2001 and 2002), Marina Energy (2002), and AirLogics (2001 and 2002). Still need 2003 SJE, 2003 Millennium, 2002 and 2003 South Jersey Resources Group, and 2003 Marina business plans.</i>	132
C	OC 64	11/1/02	1/10/03	Employee Job Descriptions Please provide all available job/position descriptions for all positions within SJI and all of its subsidiaries. <i>1/10/03--Complete--Response does not provide requested information--VP of SJG Gas Supply and VP of SJRG (same person has both positions). However, the wording in the 12/27/02 update was confusing as to what was still needed. Consider complete. 12/27/02--Update/Partial--Received Millennium descriptions. Still need descriptions for VP positions at SJG and SJRG. 12/19/02--Update/Partial--No Millennium descriptions provided. No descriptions for VP of SJG Gas Supply or VP of SJRG (same person holds both titles) provided. 12/5/02--Complete pending review--Received job descriptions for SJI, SJG, SJE. Have not determined how comprehensive the response is (e.g., how many positions do not have job descriptions). Also, Millenium job descriptions were not provided. Need to determine whether we need to issue another DR for this information or whether this DR will be supplemented.</i>	70
C	OC 65	11/1/02	12/27/02	Affiliate / ASB / Job Code Activity Report As discussed in the interview with Bob Fatzinger on October 29, 2002: Please provide the Job Code Activity Report (by technician by division) for September 2002 and December 31, 2001 which shows both monthly and year-to-date activity. In addition, please provide a key to any codes used on the report. <i>12/27/02--Complete pending review--Received the December 2001 and September 2002 Monthly Update of Job Code Summary File reports, Monthly Summary Report by Division reports, and Monthly Report by Service Person reports.</i>	56

Resp.	Dr No.	Date Sent	Date Received	Description	Elapsed Days
C	OC 66	11/1/02	12/13/02	<p>Affiliate / ASB / Warranty Terms & Conditions</p> <p>As discussed in the interview with Bob Fatzinger on October 29, 2002:</p> <p>Please provide copies of the terms and conditions of all warranty product services offered by the Appliance Service Business in 2001 and 2002.</p> <p><i>12/13/02--Complete pending review--Received a copy of the Service Sentry Program's terms and conditions.</i></p>	42
C	OC 67	11/1/02	12/13/02	<p>Affiliate / ASB / New Business Sources</p> <p>As discussed in the interview with Bob Fatzinger on October 29, 2002:</p> <p>A. If available, please provide the number of new customers and the warranty revenue generated from the 10% discount offered by AST's on time and materials service calls in 2001 and 2002. In addition, please indicate when this program first went into effect.</p> <p>B. If available, please provide the number of new customers and the warranty revenue generated from the program to give free Service Sentry warranty service to new customers (either conversions or new construction) in 2001 and 2002. In addition, please indicate when the program first went into effect.</p> <p><i>12/13/02--Complete pending review--Received responses to parts A and B.</i></p>	42
C	OC 68	11/1/02	12/5/02	<p>Affiliate / ASB / Floor Rate Support</p> <p>As discussed in the interview with Bob Fatzinger on October 29, 2002:</p> <p>Please provide the support for the floor rates established for all services offered by the Appliance Service Business in 2001 and 2002, including both time & materials and Service Sentry rates. (Bob indicated that Tom Kavanaugh should have this information.)</p> <p><i>12/5/02--Complete pending review--Received support for the Appliance Business' floor rates. The support was filed in 1999. Need to determine if this indeed applied to 2001 and 2002.</i></p>	34
C	OC 69	11/1/02	12/13/02	<p>Affiliate / ASB / Various Reports</p> <p>As discussed in the interview with Bob Fatzinger on October 29, 2002:</p> <p>Please provide the latest version of the Weekly Promotions Report, Service Sentry Report from Bonnie Bornstein's department, and Incident Rate Report. Please provide a key to all codes used on any these reports.</p> <p><i>12/13/02--Complete pending review--Received copies of the Weekly Promotions Report (as of 11/6/02), Service Sentry Report (for October), and Incident Rate Report (as of 9/30/02).</i></p>	42

Resp.	Dr No.	Date Sent	Date Received	Description	Elapsed Days
C	OC 70	11/1/02	11/18/02	Affiliate / ASB / Asset Detail As discussed in the interview with Bob Fatzinger on October 29, 2002: Please provide a detailed list of all assets to be sold to and leased by the Appliance Service Business as part of its current petition to separate from South Jersey Gas Company. For each asset with an original cost greater than \$1,000; please provide a description, year of purchase, annual depreciation rate, original cost, and accumulated depreciation. Assets costing less than \$1,000 can be grouped together. (This schedule should tie to the summary schedule included with the petition. If it does not, please provide a reconciliation.) <i>11/18/02--Complete pending review--Received multiple asset lists. Unsure if all the lists relate specifically to the assets sold/transferred to the service company. Need to review more thoroughly.</i>	17
C	OC 71	11/1/02	12/5/02	Affiliate / SJE / Incentives and Bonuses As discussed in the interview with Bob Fatzinger on October 29, 2002: Please provide a list by employee of all incentives, bonuses, etc. paid by South Jersey Energy to any employee of its affiliates (including South Jersey Industries, South Jersey Gas, the Appliance Service Business, etc.) in 2001 and 2002. <i>12/5/02--Complete pending review--Received lists for 2001 and 2002 showing the bonuses paid to employees. However, it is difficult to tell which affiliate the employees work for.</i>	34
C	OC 72	11/1/02	11/18/02	Shared Svcs / Customer Service / Bill Processing As discussed in the interview with Bonnie Bornstein on October 30, 2002: Please provide the detailed calculation of the \$0.075 charged by Customer Service to South Jersey Energy and third party marketers for each bill processed. In addition, please indicate when this rate became effective. If another rate was used during 2001 or 2002, please specify the rate used, support for the rate, and effective time period. <i>11/18/02--Complete pending review--Received information regarding the \$0.075 billing service fee.</i>	17

Resp.	Dr No.	Date Sent	Date Received	Description	Elapsed Days
C	OC 73	11/1/02	12/12/02	<p>Shared Svcs / Marketing</p> <p>As discussed in the interview with Bonnie Bornstein on October 30, 2002:</p> <p>Please provide any marketing materials, internal memos, contracts, etc. that provide additional information on the following programs:</p> <p>A. Rheem water heating installation / financing B. Heating system financing</p> <p>In addition, please identify when the program was first initiated. (Please contact Overland Consulting immediately if there are any questions concerning this request.)</p> <p>12/12/02--Complete pending review--Received information about the programs in parts A and B.</p>	41
C/NR	OC 74	11/1/02	12/27/02	<p>Shared Svcs / Customer Service / Call Statistics</p> <p>As discussed in the interview with Bonnie Bornstein on October 30, 2002:</p> <p>A. In billing the Appliance Service Business or any affiliate, please indicate the average length of time per customer call used to calculate Customer Service's billings to others during 2001 and 2002.</p> <p>B. Provide the supporting calculation for each rate identified in 1 above and the time period the rate was effective. (Dan Mercanto may have this.)</p> <p>12/27/02--Complete--Received the average length of time per customer call. Response stated that no documentation of the calculation is available. Consider complete non-responsive. 11/18/02--Partial/Non-responsive--Received responses to Parts A and B. Part A is complete. Not clear of how time per call determined or what time periods the rates in Part B relate to. Need to follow up with subject matter expert.</p>	56

Resp.	Dr No.	Date Sent	Date Received	Description	Elapsed Days
C	OC 75	11/1/02	1/10/03	Affiliate / Millennium / Various As discussed in the interview with Bonnie Bornstein on October 30, 2002: Please provide the following associated with Millennium Account Services, LLC: A. The financial plan and/or cost-benefit analysis performed to determine that the joint venture would produce savings for its partners. B. Any bids received from third parties to perform meter reading services for South Jersey Gas from 1999 to present. C. All supporting documentation for September 2002 and December 2001 invoices from Millennium to South Jersey Gas. <i>1/10/03--Complete pending review--Received an updated response. 12/27/02--Partial--Consider partial until receive further clarification regarding this analysis (e.g. is it a projection of savings prepared prior to the formation of Millenium OR a quantification of savings experienced prepared after the formation of Millenium?).Received a response stating that the data provided in response to OC-77 answers Part A of this request. Although the response to OC-77 does not appear to be a very detailed cost-benefit analysis, the Company stated that this is the analysis they used for determining cost savings from Millennium. 12/5/02--Update/Still Partial--Received data that appears to relate to Part B. Need to follow-up. Still need a response to Part A. 11/18/02--Partial--Received an answer to Part B and C. Need a response to Part A. Part B is also partial since it does not include the attachments referenced by Utility Readers, Ltd.</i>	70
C	OC 76	11/1/02	12/27/02	Shared Svcs / Customer Service / Call Categorizatr As discussed in the interview with Bonnie Bornstein on October 30, 2002: Please provide a copy of the Call Categorization Report for each month from January 2001 to September 2002 which shows a breakdown by type of call. Please provide a key to any codes used in this report. <i>12/27/02--Complete--Received a response stating that the January 2001 report is not available due to the work stoppage that the Company faced during that time period. Consider complete. 11/18/02--Partial--Received the Call Categorization Reports for February 2001 to October 2002. Still need January 2001 report.</i>	56

Resp.	Dr No.	Date Sent	Date Received	Description	Elapsed Days
C	OC 77	11/1/02	1/10/03	Affiliate / Millennium / Cost Savings As discussed in the interview with Executive Management on October 31, 2002: Please provide any analysis performed in 2000, 2001, or 2002 indicating the savings generated by Millennium Account Services, LLC for South Jersey Gas. <i>1/10/03--Complete pending review--Received an updated response indicating no formal analysis was performed. The response also provided budget to actual meter reading costs. 12/5/02--Partial/Nearly Complete--Received a spreadsheet showing the cost to read meters by SJG. This was then compared to the 1999 Millennium cost to read meters. Therefore, the data provided probably relates to 1999. It was not stated if the same analysis applies to 2000, 2001, and 2002. Unsure if any additional studies were prepared for other years. Need a response stating what years the analysis relates to and/or that no other studies were prepared to monitor cost savings.</i>	70
C	OC 78	11/1/02	11/21/02	Accounting / Management Service Fee / Detail Referencing the response to OC-47 (management service fee): A. Please provide a detailed listing of all "Other Professional Services" for each month from January 2001 to September 2002. B. Please identify the employees included in both "Salaries & Wages" and "Officer's Salaries" for each month from January 2001 to September 2002 and indicate whether each of these employees' total salaries are included in the management service fee or only part of their salary. C. If not explained by the answers to A and B above, please distinguish between the amounts recorded as "management service fee" and those identified as "corporate and fiscal expense". <i>11/21/02--Complete pending review--Dave Robbins clarified the response sent earlier. 11/18/02--Partial--Received answers for Parts A, B, and C. The response for Part A does not clearly detail the "Other Professional Services"; need to follow up with Dave Robbins. The answer for Part B does not answer the request.</i>	20

Resp.	Dr No.	Date Sent	Date Received	Description	Elapsed Days
C/NR	OC 79	11/1/02	1/10/03	Fin Data / Consolidating Financial Statements As discussed in the interview with Tom Kavanaugh on November 1, 2002: Please provide the quarterly consolidating financial statements for South Jersey Industries in 2001 and 2002. <i>1/10/03--Complete/Non-responsive--Received "back-up" for the Company's consolidating financials but did not receive all elimination entry explanations. The fact that SJI can not explain all of their eliminations justifies a complete/non-responsive designation. 12/27/02--Partial--Elim explanations need to include entities involved in the elimination as well as amounts. In addition, an e-mail sent to R. Walker on 12/31 requested clarification of certain comments made on 12/27 cover sheet response. Received eliminating entry "explanations" for the quarterly income statements without a description of the entities involved. 12/19/02--Update/Partial--Did not receive the eliminating entry explanations. 11/18/02--Complete--Received the SJI quarterly consolidating financial statements.</i>	70
C	OC 80	11/1/02	11/18/02	Fin Data / Time Sheet Summary As discussed in the interview with Tom Kavanaugh on November 1, 2002: Please provide the monthly Time Sheet Summary in electronic format for the time period from January 2001 to September 2002. <i>11/18/02--Complete pending review--Received 2001 and 2002 time sheet summary data in electronic format.</i>	17
C	OC 81	11/5/02	12/5/02	Internal Audit / Request for Various Reports Referencing the response to OC-23, please provide copies of the reports for the following internal audits: 1) SJG - Financial Planning (2000) 2) SJG - Appliance Service Efficiency & Effectiveness (2000) 3) SJG - Fleet Management Audit (2000) 4) SJES - Retail Electricity (2001) 5) SJG - Flat Rate Pricing & Service Sentry (2001) 6) SJG - LGAC Credit (2002) 7) SJG - Meter Operations (2002) <i>12/5/02--Complete--Received copies of the requested audit reports.</i>	30

Resp.	Dr No.	Date Sent	Date Received	Description	Elapsed Days
C	OC 82	11/15/02	12/27/02	Auditor Management Letters Please provide, for fiscal years 2000, 2001, and 2002: a) any "Management Letters" sent by the entities' external auditors to SJI, its affiliates, or its subsidiaries (covering any findings, recommendations, etc.) based on their audits. b) management representation letters provided to the entities' external auditors by SJI or any of its affiliates or subsidiaries. <i>12/27/02--Complete--Received the 1999, 2000, and 2001 fiscal year letters for part a). Still need 2002 letters when available. Consider complete as Overland has all currently available letters. 12/12/02--Partial--Received the following for part b) SJI and SJG letters to its auditor, Deloitte and Touche, from 2000 and 2001. Still need the 2002 letters when available. Still need part a).</i>	42
C	OC 83	11/15/02	12/27/02	Telecommunications Data Please provide, for fiscal years 2001 and 2002, a summary of all telecommunications charges, broken down by location with related employee data per each location. The summary should include costs related to local landline, long distance landline, and wireless communications. If possible, the summary should include a calculation of the telecommunications costs per employee at each location. <i>12/27/02--Complete pending review--Received 2001 and 2002 (11 months) telecommunications data for each division including a cost per employee at each location. The costs, however, are not specified as local, long distance, or wireless.</i>	42
P	OC 84	11/15/02		Board Meeting Minutes Please make available for review during an upcoming field visit, SJI's, its affiliates' (including Millenium), and its subsidiaries' Board of Director (Executive Committee) meeting minutes for meetings held in FY 2001 and FY 2002 to date. If not included in the minutes, please also provide access to all presentation materials, hand-outs, etc. reviewed at these meetings. (Comment: This DR was amended to include "Executive Committee" and "presentation materials, hand-outs, etc." on 11/27/02.) <i>1/10/03--Partial--Still need to review the November 2002 minutes. 12/20/02: Partial -- Company made available SJI, SJE, SJG, and Millennium BOD or Exec Committee minutes. However, November 2002 minutes had not yet been formalized for any entities -- Overland still to review. Also, "gaps" in Millennium minutes were evident: 3/24/99 - 2/8/00 and 7/01 - 11/01.</i>	118

Resp.	Dr No.	Date Sent	Date Received	Description	Elapsed Days
C	OC 85	12/3/02	12/27/02	<p>Fin Data / Rating Agency Correspondence</p> <p>Please provide a copy of all written correspondence between South Jersey Gas Company, its parent, or its affiliates AND the following parties in 2001 and 2002:</p> <p>1) Moody's 2) Standard & Poor's 3) Any other debt rating agency</p> <p><i>12/27/02--Complete pending review--Received copies of various letters and e-mails between the Company and rating agencies as well as other rating agency documentation related to the Company. The other data provides responses to other data requests.</i></p>	24
C/NR	OC 86	12/3/02	1/10/03	<p>Business Plans / SJI SJG / 2003</p> <p>Please provide copies of all 2003 business plans, strategic plans, and/or service plans for South Jersey Gas, South Jersey Industries, or any of their internal departments/divisions. If not final, drafts are acceptable if marked accordingly.</p> <p>If not final, please indicate when final reports are scheduled to be approved. Please update this request as plans are finalized.</p> <p>(This is an extension of OC-32 which only asked for 2000-2002 business and/or strategic plans for SJG and SJI. 2003 business plans for all other significant operating affiliates should be provided in response to OC-63. If other 2003 business plans, strategic plans, and/or service plans exist for 2003; Overland should be contacted immediately so that they can be incorporated in this request.)</p> <p><i>1/10/03--Complete/Non-responsive--Received a response stating that all business plans are in draft form and will not be ready until March 2003. Overland requested that drafts be provided and marked accordingly if final plans were not available. SJI did not provide their draft business plans.</i></p>	38
C	OC 87	12/3/02	12/13/02	<p>Fin Data / Forecasts / 5-Year and 10-Year</p> <p>As discussed in the interview with Paul Straub on November 20, 2002:</p> <p>1) Please provide copies of the most recent 5-year forecast prepared for SJG and SJI.</p> <p>2) Please provide a copy of the most recent 10-year requirements (supply) forecast prepared for SJG.</p> <p><i>12/13/02--Complete--Received the most recent 5-year forecast (Part 1) and 10-year requirements forecast (Part 2).</i></p>	10

Resp.	Dr No.	Date Sent	Date Received	Description	Elapsed Days
C	OC 88	12/3/02	12/13/02	<p>Fin Data / Accounting Committee Materials</p> <p>As discussed in the interview with Paul Straub on November 20, 2002:</p> <p>As it relates to the monthly Accounting Committee Meeting,</p> <p>1) Please provide copies of the "accounting committee package" (which includes explanations of significant fluctuations in financial results) for each month from January 2001 to September 2002.</p> <p>2) Please provide copies of the Accounting Committee Meeting summary memo for each month from January 2001 to September 2002.</p> <p>3) Please provide copies of the monthly margin analysis for each month from January 2001 to September 2002.</p> <p><i>12/13/02--Complete--Received the requested reports from Parts 1, 2, and 3.</i></p>	10

Resp.	Dr No.	Date Sent	Date Received	Description	Elapsed Days
C	OC 89	12/3/02	12/27/02	<p>Fin Data / Budgets / 2002</p> <p>As discussed in the interview with Paul Straub on November 20, 2002:</p> <p>As it relates to the 2002 budget:</p> <p>1) Please provide copies of the annual 2002 budgets (capital and operating) for SJG and all of its affiliates (including SJI and Millenium) at both a summary and detailed level.</p> <p>2) Please provide the most current "updated budget" for 2002 for SJG and all of its affiliates (including SJI and Millenium) at both a summary and detailed level. If not apparent, please indicate when this update was prepared.</p> <p>3) If available, please provide a consolidated and consolidating SJI annual budget for 2002.</p> <p>4) If available, please also provide a consolidated and consolidating SJI "updated" annual budget for 2002.</p> <p>5) Please distinguish between the information provided in "1" and "3" above and the "budget books" mentioned by Mr. Straub in the interview.</p> <p>All of this information should be provided electronically (preferably in Excel) if available. (Mr. Straub indicated that he prepares the budget in spreadsheet format.)</p> <p><i>12/27/02--Complete pending review--Received an update for Parts 1 and 5. Consider complete. 12/13/02--Partial--Received the following data: Part 1) the annual 2002 SJI and SJG budgets (capital and operating). Millennium does not appear to be included in these budgets [partial]. Part 2) the Company states that the response to OC-90 provides the most current updated budget for 2002. It is not apparent when it was prepared and Millennium is not included [partial]. Part 3) the data provided to Part 1) includes the 2002 SJI annual budget [complete]. Part 4) the Company states the response to OC-90 also addresses this request. However, it does not appear to provide "consolidating" formats. The Company should state what has been provided and confirm if consolidating formats are available/not available [partial]. No data was provided for Part 5 [no response].</i></p>	24

Resp.	Dr No.	Date Sent	Date Received	Description	Elapsed Days
C	OC 90	12/3/02	12/27/02	Fin Data / Budgets / 2003 As discussed in the interview with Paul Straub on November 20, 2002: 1) Please provide a copy of the approved 2003 budget for SJG and all of its affiliates at a summary and detailed level. 2) If available, please provide a copy of the approved 2003 consolidated and consolidating SJL budgets. All of this information should be provided electronically (preferably in Excel) if available. (Mr. Straub indicated that he prepares the budget in spreadsheet format.) <i>12/27/02--Complete pending review--Received a response stating that all budget data has been submitted in response to this request and requests OC-88, OC-89, and OC-91. Consider complete. 12/13/02--Partial--Received the following data: Part 1) updated 2002/approved 2003 budget for SJG and Part 2) updated 2002/approved 2003 budget for SJL. The budgets provided differ than the approved 2002 budgets provided in response to OC-89. Not sure if these are the complete budget packages for 2003. Need to follow-up.</i>	24
C	OC 91	12/3/02	12/13/02	Fin Data / Budgets / Interco Transactions As discussed in the interview with Paul Straub on November 20, 2002: Please provide a copy of all intercompany transactions budgets prepared for 2001, 2002, and 2003 (when available). <i>12/27/02--Update--Received 2003 data. 12/13/02--Complete pending review--Received copies of the 2001 and 2002 intercompany transactions budgets. 2003 is not yet available.</i>	10
C	OC 92	12/3/02	12/27/02	Affiliate / SJG Corporate Guarantees Please identify and provide all South Jersey Gas guarantees of affiliate obligations effective at any point during the period January 1, 2001 to September 30, 2002. Provide the title of the guarantee agreement, date of the agreement, termination date of the agreement, affiliate, third party beneficiary of the guarantee, amount of the guarantee and a copy of the guarantee agreement. <i>12/27/02--Complete pending review--Received a response stating that the Company (SJG) does not and has not guaranteed affiliate debt obligations.</i>	24

Resp.	Dr No.	Date Sent	Date Received	Description	Elapsed Days
C	OC 93	12/3/02	1/10/03	<p>Affiliate / Millennium / Read-Write Access</p> <p>As discussed in the interview with Joe Scaffidi on November 20, 2002:</p> <p>Please provide one of the following:</p> <p>A) A list of the SJG data fields to which Millennium employees either have "read" or "write" access. Please differentiate which data fields can be modified by Millennium employees.</p> <p>B) "Print screens" of all SJG data to which Millennium employees either have "read" or "write" access. Please differentiate which fields on these screens can be modified by Millennium employees.</p> <p><i>1/10/03--Complete--Received follow-up information clarifying inconsistencies. 12/31/02--Partial--Received a description of what data Millennium employees can view and edit as well as the two "print screens" that can be viewed. Inconsistent with 12/19/02 and 12/20/02 interview with Pat Finnigan. Pat said employees have access to customer screen info.</i></p>	38

Resp.	Dr No.	Date Sent	Date Received	Description	Elapsed Days
C	OC 94	12/3/02	1/10/03	<p>Affiliate / Millennium / Cost Billed by Connectiv</p> <p>As discussed in the interview with Joe Scaffidi on November 20, 2002:</p> <p>Please quantify the following:</p> <p>1) Total amount of insurance pass-through costs billed by Connectiv Power Delivery (or one of its affiliates) to Millennium for the 12 months ended December 31, 2001 and the nine months ended September 30, 2002. (This should only include third party billings to Connectiv that were passed on to Millennium -- e.g., Marsh & McClennan)</p> <p>2) Total amount of costs billed by Connectiv Power Delivery (or one of its affiliates) to Millennium for administering the insurance function on behalf of Millennium. Please quantify for the 12 months ended December 31, 2001 and the nine months ended September 30, 2002. (This should include such things as Connectiv employee time.)</p> <p>3) Total amount of income tax pass-through costs billed by Connectiv Power Delivery (or one of its affiliates) to Millennium for the 12 months ended December 31, 2001 and the nine months ended September 30, 2002. (This should only include third party billings to Connectiv that were passed on to Millennium -- e.g., CPA firm)</p> <p>4) Total amount of costs billed by Connectiv Power Delivery (or one of its affiliates) to Millennium for administering the income tax function on behalf of Millennium. Please quantify for the 12 months ended December 31, 2001 and the nine months ended September 30, 2002. (This should include such things as Connectiv employee time.)</p> <p>5) Total amount of other costs billed by Connectiv Power Delivery (or one of its affiliates) to Millennium for the 12 months ended December 31, 2001 and the nine months ended September 30, 2002. Please identify the specific nature of the costs.</p> <p><i>1/10/03--Complete--Received answers to the questions posed in the request.</i></p>	38

Resp.	Dr No.	Date Sent	Date Received	Description	Elapsed Days
C	OC 95	12/3/02	1/10/03	<p>Affiliate / Millennium / Itron & 5-Year Contracts</p> <p>As discussed in the interview with Joe Scaffidi on November 20, 2002:</p> <p>According to Mr. Scaffidi, one reason Millennium and its customers signed new 5-year contracts was to spread the cost of the Itron equipment purchase over a sufficient number of years to make Millennium whole without being cost prohibitive to either SJG or Connectiv.</p> <p>1) Please confirm that Overland has properly characterized one of the primary motives in executing the 5-year contracts between Millennium and its two customers (SJG and Connectiv).</p> <p>2) If the Overland characterization is incorrect, please explain.</p> <p>3) When negotiating the length (duration) of the new contract between SJG and Millennium, were different terms (length of contract) discussed?</p> <p>4) If so, what alternatives were discussed?</p> <p>5) To be made whole, what pricing would Millennium have had to charge SJG per meter if a 1-year contract had been signed rather than a 5-year contract? A 2-year contract? A 3-year contract? A 4-year contract? (If the Company does not understand this multi-part question, it should contact Overland immediately.)</p> <p>6) Was the length (duration) of SJG's contract with Millennium contingent on the length (duration) of contract between Millennium and Connectiv?</p> <p>7) If so, what steps did Millennium, the partners, and the related customers take to ensure that the negotiations were handled in an arms-length manner between all parties?</p> <p>8) If not, what steps was Millennium prepared to take if only one of its customers was willing to commit to a 5-year contract (e.g., forego the purchase of new equipment, require the interested customer to sign an even longer contract, require the interested customer to pay a higher price, etc.)?</p> <p><i>1/10/03--Complete pending review--Received a follow-up response for the request with additional information. 12/31/02--Partial--Received answers to Parts 1 through 4 and 6 through 8. Need Part 5. Company stated that Joe Scaffidi can provide this but is on vacation until 1/6/03.</i></p>	38

Resp.	Dr No.	Date Sent	Date Received	Description	Elapsed Days
C	OC 96	12/3/02	1/8/03	<p>Affiliate / Millennium / Meter Read Costs</p> <p>As discussed in the interview with Joe Scaffidi on November 20, 2002:</p> <p>1) Please provide a copy of the detailed calculation prepared by South Jersey Gas to quantify its internal cost per meter read in late 1998 / early 1999. (According to Al Ruggiero, this cost per meter read served as the basis for determining the initial price billed by Millennium to SJG.)</p> <p>2) Confirm that the prices between Millennium and SJG for the first 3 years were:</p> <p>A) 1st Year: SJG internal cost per meter read LESS 10%</p> <p>B) 2nd & 3rd Years: SJG internal cost per meter read LESS 20%</p> <p>3) If necessary, please reconcile the calculated prices based on "1" and "2" above to the actual price agreed to by the parties as documented in the contract.</p> <p><i>1/8/03--Complete pending review--Received answers to Parts 1 through 3. The detailed calculation provided for Part 1 does not appear to be Company workpaper documentation and is not extremely detailed. The calculation was given on the face of the response.</i></p>	36
C	OC 97	12/3/02	1/10/03	<p>Affiliate / Millennium / Leases</p> <p>As discussed in the interview with Joe Scaffidi on November 20, 2002:</p> <p>Please provide the following documents executed at the time when Millennium was first created (according to Al Ruggiero):</p> <p>1) Contract between Millennium and SJG/SJI involving "leasing" of employees. Please provide all support for the determination of the pricing between the two parties.</p> <p>2) Contract between Millennium and SJG/SJI involving lease of assets. Please provide all support for the determination of the pricing between the two parties.</p> <p><i>1/10/03--Complete--Received the contracts requested and a follow-up e-mail from Rick Walker on 1/16/03 (related to a seconding agreement mentioned in the response to Part 1).</i></p>	38

Resp.	Dr No.	Date Sent	Date Received	Description	Elapsed Days
C	OC 98	12/3/02	12/27/02	<p>Affiliate / Millennium / Internal Audits</p> <p>As discussed in the interview with Joe Scaffidi on November 20, 2002:</p> <p>1) If not already provided in response to OC-81, please provide all internal audit reports prepared by SJG's internal audit department concerning Millenium. (If the report(s) only consists of an opinion, please provide the underlying workpapers.)</p> <p>2) Please provide all internal audit reports conducted by Connectiv's internal audit department on Millennium. (If the report(s) only consists of an opinion, please provide the underlying workpapers.)</p> <p><i>12/27/02--Complete pending review--Received a copy of an audit report dated September 20, 2000 for Millennium. The response states that the Company is not aware of any Connectiv internal audit reports.</i></p>	24
C	OC 99	12/3/02	1/10/03	<p>Affiliate / Millennium / BPU Filing Re: Asset Trfr</p> <p>As discussed in the interview with Joe Scaffidi on November 20, 2002:</p> <p>Please provide SJG/SJI's filing to the NJBPU concerning the transfer of assets from the utility to Millennium (including all associated attachments and exhibits) and all related correspondence between the two parties subsequent to this filing.</p> <p><i>1/10/03--Complete pending review--Received an SJG filing with the BPU related to asset transfers from the utility to Millennium.</i></p>	38
C	OC 100	12/3/02	12/27/02	<p>Affiliate / Millennium / Bid Correspondence</p> <p>Referencing the original response to OC-75:</p> <p>1) Please provide the "quote" and all associated detail from VSI Group that was provided to SJG "8 months ago" (latter half of 2000 based on date of cover letter).</p> <p>2) Was the quote received in the latter half of 2000 from VSI Group in response to a request from SJG?</p> <p>3) If so, please provide the request for proposal or any other written documentation sent by SJG to third parties.</p> <p>4) If the answer to 2 above is "yes", did SJG request other companies to provide "quotes"?</p> <p>5) If so, please provide all responses to this SJG request, including supporting detail, attachments, etc.</p> <p><i>12/27/02--Complete pending review--Received responses to parts 1 through 5.</i></p>	24

Resp.	Dr No.	Date Sent	Date Received	Description	Elapsed Days
C	OC 101	12/3/02	12/27/02	Affiliate / Millennium / Bid Correspondence Referencing the original response to OC- 75: Please provide the letter dated August 11, 2000 from Bonnie Bornstein (SJG) referenced by Utility Readers, Ltd. in its 8/24/00 letter and any associated attachments, exhibits, etc. In addition, please provide any other information forwarded to Utility Readers, Ltd., VSI Group, etc. by SJG as part of this "request for proposal" process. <i>12/27/02--Complete pending review--Received the letter from Bonnie Bornstein dated August 11, 2000 as well as other "request for proposal" information in response to OC-100. The response to OC-101 refers to the data submitted for OC-100.</i>	24

Resp.	Dr No.	Date Sent	Date Received	Description	Elapsed Days
C	OC 102	12/3/02	1/8/03	<p>Accounting / Insurance / Prudential De-mutualizatn</p> <p>As discussed in the interview with Dave Robbins on November 21, 2002:</p> <p>As it relates to the Prudential Insurance de-mutualization:</p> <p>1) Please provide a general description of the transaction, the historical employee benefit that gave rise to the recent transaction (e.g., life insurance benefit offered on a complimentary basis to all employees, an optional employee benefit paid for by employees, key man life insurance carried by the company on certain executives, etc.), the specific time period that SJI/SJG purchased life insurance from Prudential, etc.</p> <p>2) Please provide all workpapers, calculation, memos, etc. concerning the handling of the Prudential insurance de-mutualization by SJI, SJG, or any of its affiliates. This should include, but not be limited to, the quantification of employer- and employee-funded amounts, the intended handling of employer and employee-paid amounts, the intended treatment of life insurance associated with current employees vs. former employees, the decision to allocate employer-paid amounts through use of the 3-factor formula, etc.</p> <p>3) Please provide the journal entry, cash receipt entry, etc. that was recorded by SJI when the cash was received from the Prudential de-mutualization.</p> <p>4) Please confirm that the proceeds from the Prudential de-mutualization were allocated to SJI's underlying subsidiaries using the then current 3-factor formula.</p> <p>5) Please provide the journal entry that was recorded by SJI when it allocated the proceeds to its subsidiaries.</p> <p>6) If not previously provided in response to 3 above, please provide the journal entry that was recorded by SJI or any of its subsidiaries to record the amount of proceeds related to employee-funded insurance.</p> <p>6) Please provide the journal entry that was recorded by SJG when it was allocated the proceeds of the Prudential de-mutualization from SJI.</p> <p>7) Please confirm that no subsequent reclassifications to other accounts have been recorded by SJI or SJG as it relates to the accounting for the Prudential insurance de-mutualization.</p> <p>1/8/03--Complete-Received responses for Parts 1 through 8. Parts 1, 4, 7, and 8 are complete. Part 2 is missing the handling of insurance related to current v. former employees. Parts 3, 5, and 6 asked for journal entries. Support was provided. However, it</p>	36

Resp.	Dr No.	Date Sent	Date Received	Description	Elapsed Days
				<i>does not appear that we received system generated journal entries. Must review to determine if all the needed information was provided. Consider complete.</i>	
C	OC 103	12/3/02	12/27/02	Affiliate / Interco AR & AP Reconciliations As discussed in the interview with Dave Robbins on November 21, 2002: Please provide a cross-referenced tie-out of the intercompany payable and receivable balance with SJG on SJI's general ledger for December 2001. At a minimum this should include: 1) Reconciliation of SJG intercompany payable and receivable balance with SJI intercompany receivable and payable balance. 2) Reconciliation of the amounts appearing on the intercompany invoices between SJG and SJI with the activity recorded in the intercompany payable and receivable accounts of both companies. 3) Support (back-up) for all items listed on the intercompany invoices between SJG and SJI. 12/27/02--Complete pending review--Received responses to Parts 1 through 3.	24
C	OC 104	12/3/02	12/27/02	Accounting / Management Service Fee / Act vs Budgt As discussed in the interview with Dave Robbins on November 21, 2002: Please provide the actual vs. budgeted management service fee analysis prepared by Dave Robbins' department for each month from January 2001 to September 2002. 12/27/02--Complete pending review--Received the September, October, and November 2002 management service fee analysis. The response states that the analysis was not "kept" before September of 2002.	24

Resp.	Dr No.	Date Sent	Date Received	Description	Elapsed Days
C	OC 105	12/3/02	12/27/02	<p>Affiliate / SJI SJG / Interco AR & AP Detail</p> <p>As discussed in the interview with Dave Robbins on November 21, 2002:</p> <p>1) Please provide SJI's "Summary of Open Items" for A/C's 146-02 and 234-02 for every month from January 2001 to September 2002.</p> <p>2) Please provide SJI's "Summary of Open Items" for all other intercompany payable and receivable accounts for December 2001 and September 2002.</p> <p>3) Please provide SJI's rollforward of all intercompany payable and receivable accounts as of September 2002. At a minimum, the rollforward should begin with January 2001. (Note: This type of rollforward was provided to Overland by Dave Robbins on November 21, 2002 for A/C's 234-02 and 146-02.)</p> <p>4) To the extent similar information is available for SJG's intercompany payable and receivable accounts, please provide this documentation also. (e.g., monthly reconciliations of all interco accounts, rollforwards of all interco accounts from January 2001 to September 2002, etc.)</p> <p>12/27/02--Complete pending review--Received responses to Parts 1 through 4.</p>	24
C	OC 106	12/3/02	12/27/02	<p>Affiliate / ASB / Branding and Logo</p> <p>On August 16, 2002, SJG petitioned the NJBPU to transfer its Appliance Service Business to newly created company effective January 1, 2003.</p> <p>1) What brand name(s) will the Appliance Service Business use to promote its services under the newly created company?</p> <p>2) Please provide copies of the logos to be used by the Appliance Service Business when it is transferred to the newly created company.</p> <p>12/27/02--Complete--Received responses to Parts 1 and 2.</p>	24

Resp.	Dr No.	Date Sent	Date Received	Description	Elapsed Days
C	OC 107	12/3/02	1/8/03	<p>Affiliate / ASB / Target Marketing</p> <p>As discussed in the interview with Joe Scheufele on November 22, 2002:</p> <p>1) Please confirm that the following is true: The Appliance Service Business (ASB) has had access to and used the utility customer database for purposes of target marketing. For example, in the past, the ASB has chosen to send bill inserts only to those utility customers not subscribing to its Service Sentry service program. However, competitors have not been allowed to receive similar information or to utilize the utility customer database in the past.</p> <p>If not true, please explain in detail.</p> <p>2) Has the utility been compensated by the ASB for its access to and use of the utility's customer database?</p> <p>3) If so, how much did the ASB pay the utility for its access to and use of the utility's customer database during the twelve months ended December 31, 2001 and nine months ended September 30, 2002?</p> <p><i>1/8/03--Complete pending review--Received responses to Parts 1 through 3.</i></p>	36
C	OC 108	12/3/02	1/10/03	<p>Affiliate / ASB SJE / In-Home Brochure</p> <p>As discussed in the interview with Joe Scheufele on November 22, 2002:</p> <p>Please provide a copy of the "in-home brochure" handed out by appliance service technicians to customers concerning SJE's products and services. In addition, please provide any internal memos, directions, etc. that explain the "do's and don't's" of handing out this information.</p> <p><i>1/10/03--Complete--Received the requested information.</i></p>	38

Resp.	Dr No.	Date Sent	Date Received	Description	Elapsed Days
C	OC 109	12/3/02	1/8/03	<p>Affiliate / ASB / Access to Customer Data In the past, Appliance Service Business (ASB) has had access to utility customer data to which its competitors have not had access. If and when the ASB is split off into its own separate company, this access will presumably no longer be allowed.</p> <p>1) Please confirm that the above statement is true.</p> <p>2) Please explain how the ASB will be prevented from using in the future information it has accumulated over time concerning utility customers.</p> <p>3) Does SJG intend to provide competitors any access to its utility customer database in order to "level the playing field" with the ASB?</p> <p>4) If so, what specific information does SJG intend to provide competitors? <i>1/8/03--Complete pending review--Received responses to Parts 1 through 4.</i></p>	36
C	OC 110	12/3/02	1/10/03	<p>BPU / Complaints Against SJG Please provide copies of all competitor or customer complaints concerning possible SJG non-compliance with the Electric Discount and Energy Competition Act or the NJBPU's Affiliate Relations, Fair Competition & Accounting Standards during 2001 and 2002. <i>1/10/03--Complete--Received a response stating that no complaints have been received by SJG related to compliance/non-compliance with the Energy and Affiliate Standards.</i></p>	38
C	OC 111	12/3/02	12/27/02	<p>Fin Data / Debt Term Sheets Please provide a copy of any "term sheets" summarizing the terms and conditions of all existing SJI, SJG, and other SJI affiliates' long term debt and lines of credit. <i>12/27/02--Complete pending review--Received the Company's term sheets summarizing its outstanding debt.</i></p>	24
C	OC 112	12/9/02	12/12/02	<p>Utility / Third Party Gas Marketers Separately, for fiscal years 2001 and 2002, please provide lists of third party suppliers who South Jersey Gas considers to have actively marketed the gas commodity on a retail basis in its service area. To the extent known, please indicate for each TPS whether they were actively marketing to residential customers, commercial customers, or both. <i>12/12/02--Complete--Received lists of third party marketers for 2001 and 2002.</i></p>	3

Resp.	Dr No.	Date Sent	Date Received	Description	Elapsed Days
C	OC 113	12/9/02	1/8/03	Shared Svcs / Information Systems Please provide the following information: A) A listing/description of any information systems shared by more than one affiliate. The list should identify which affiliates share each of the systems. B) A description of the time period(s) over which the information systems listed in Part A were developed (or purchased from third parties if not developed internally). 1/8/03--Complete--Received responses to Parts A and B.	30
C	OC 114	12/9/02	12/27/02	Accounting / Software Capitalization Policy Please provide the following information: A) A written description of the Company's capitalization policy for the costs of developing software for internal use. B) An explanation of whether the current policy described in Part A changed as a result of the issuance of SOP 98-1--"Accounting for the Costs of Computer Software Developed or Obtained for Internal Use." C) If the current policy described in Part A changed because of the issuance of SOP 98-1, provide a written description of the Company's previous capitalization policy for the costs of developing software for internal use. 12/27/02--Complete pending review--Received responses to Parts A, B, and C.	18
	OC 115	12/9/02		Fin Data / Rating Agency Reports Please provide the following rating agency information: A) Moody's Summary Opinion dated September 18, 2002. B) Moody's Opinion Update dated September 13, 2002. C) Any Standard and Poor's information (for example, any new reports) not provided in OC-42. 0	94

Resp.	Dr No.	Date Sent	Date Received	Description	Elapsed Days
P	OC 116	12/19/02		Accounting / Cost Allocation / Follow-up Questions Please provide responses to the follow-up cost allocation questions submitted to Rick Walker via e-mail on 12/19/02. <i>1/15/03--Update--Received a set of SJE consolidating financial statements in response to OC-116. These financials do not relate to the unanswered question. Still Partial. 1/8/03--Partial--Received answers to all but one of the questions in the data request. Question 6 was not answered. The Company stated in their answer that the information would be provided separately, but no attachment for question 6 was given.</i>	84
C	OC 117	12/20/02	12/27/02	Board Meeting Exhibits Referring to the Board of Directors materials provided on December 17 in the blue binders entitled "Exhibits 1/2002 - " and "Exhibits May 2000 - Nov 2001", please provide copies of the following materials marked with green flags: a. SJI Summary of Proposed Dividend Declarations (copies dated 11/22/02 in the "Exhibits 2002" binder and 11/18/02(?) and 11/16/01 in the "Exhibits May 2000 - Nov 2001" binder.) b. S&P Electric / Gas / Water Report Card, p. 44, dated August, 2002 with the discussion about SJG. (2002 binder) c. SJI and Subsidiaries Lines of Credit, 6/1/02 to 5/31/03 (2002 binder) d. Copy of Philadelphia Business Journal article "Utility's non-utility ventures gas up profits", dated 4/12/02 (2002 binder). e. SJRG Mark to Market Summary Report (approx. midway through the 2002 binder). f. Deloitte and Touche Study of Energy Company Financial Reporting Practices, January, 2002. (2002 binder). g. SJG 2000-2001 LGAC Summary (2001 binder). h. Borgata Energy Services Contract summary (2001 binder) <i>12/27/02--Complete--Received the requested data for Parts a through h.</i>	7

Resp.	Dr No.	Date Sent	Date Received	Description	Elapsed Days
C	OC 118	12/20/02	12/20/02	Affiliate / SJE / Marketing Materials Please provide copies of the following SJE marketing materials: a. Brochure titled "Practical Solutions for Today's Energy Market" b. "Gift Card" brochure with business reply mail card c. "Choose this" door hanger distributed by Millenium employees d. "Guaranteed Savings of 12% per Decatherm" commercial brochure. e. "Switch, Save, Support" Gift Card brochure f. "Savings Inside" brochure describing both appliance services and SJE savings <i>12/27/02--Complete--Received the requested data for Parts a through f. (12/20/02 date used for receipt since info provided immediately to Overland in field.)</i>	0
C	OC 119	12/20/02	1/10/03	Affiliate / SJE / Marketing Scripts Please provide a copies of: a. "CustomerLink & South Jersey Energy Residential Natural Gas Outbound" telemarketer script dated 11/14/02 used by SJE to market services (discussed in the interview with Mike Renna). b. All previous versions of telemarketing scripts used to market SJE services. <i>1/10/03--Complete--Received a follow-up response for Part b. 12/27/02--Partial--Received the script requested in part a. Did not receive any other scripts as requested in part b or an explanation that no such scripts exist.</i>	21
C	OC 120	12/20/02	12/20/02	Affiliate / ASB / Internal Audit Report Please provide a copy of Internal Audit Report 24-2001 concerning appliance service discounts, dated October 25, 2001. <i>12/20/02--Complete--Received a copy of Internal Audit Report 24-2001.</i>	0
C	OC 121	12/20/02	1/10/03	Affiliate / SJE / Community Rewards Program Please provide Information describing the "community rewards" program by which employees and others may be compensated for providing customer referrals to SJE. <i>1/10/03--Complete--Received a follow-up response providing additional information from the employee's perspective. 12/27/02--Partial--Received a "community rewards" brochure. However, did not receive a description of the program from the perspective of the employees and/or other persons promoting the program (e.g. eligibility, amount of incentive, etc.)</i>	21

Resp.	Dr No.	Date Sent	Date Received	Description	Elapsed Days
C	OC 122	12/20/02	1/10/03	Affiliate / SJE / Contracts Please provide a copy of the following SJE contracts for the calendar years 2001 and 2002: <ul style="list-style-type: none"> a. With Millenium for the distribution of SJE marketing materials (the door hangers) b. With telemarketers c. With other third-party marketers. <i>1/10/03--Complete pending review--Received the requested contracts.</i>	21
	OC 123	12/20/02		Business Plans / SJI SJG SJE MAS SJRG ME / 2003 To the extent that OC-63 and OC-86 have not been answered because information has not been "finalized", please provide the 2003 business plans, strategic plans, and/or service plans in their current draft status for South Jersey Gas, South Jersey Industries, and any of their affiliates, subsidiaries, joint ventures, or internal departments / divisions / business segments. 0	83
	OC 124	12/20/02	1/10/03	BPU / Cross Subsidy Precedent Please provide copies of any orders, rulings, findings, etc. from the New Jersey Board of Public Utilities (NJBPU) that the Company believes establishes a precedent regarding the price that is permitted to be charged between a utility and its affiliates for products and services. To the extent the NJBPU has a standard by which it measures whether or not cross-subsidization between a utility and its affiliates has occurred, this should also be provided. <i>1/10/03--Complete pending review--Received response providing BPU literature.</i>	21

Resp.	Dr No.	Date Sent	Date Received	Description	Elapsed Days
C	OC 125	12/20/02	1/10/03	<p>Affiliate / Descriptions and History</p> <p>Please provide a brief history or background of the following entities:</p> <p>South Jersey Gas Company Appliance Service Business South Jersey Industries, Inc. South Jersey Energy Company South Jersey Resources Group, LLC Marina Energy LLC Millenium Account Services, LLC</p> <p>To the extent that it is not already included in the "Company Profile" provided to Overland on October 31, 2002 or the 10-K, this should include date of formation, significant acquisitions and/or dispositions since formation, approximate number of current customers in total and by class (e.g. commercial, industrial, residential, etc.), etc.</p> <p><i>1/29/03--Update--Received additional information regarding SJE sales volumes. 1/10/03--Complete pending review--Received the most recent SJI 10-K.</i></p>	21
C	OC 126	12/20/02	1/10/03	<p>Shared Svcs/ HR / Salary Bands</p> <p>As discussed in the interview with Sharon Pennington on December 12, 2002:</p> <p>A. Please provide the salary bands associated with each "Grade" for the years 2001 and 2002.</p> <p>B. Confirm that the salary bands are consistent from department to department and company to company. If not, please provide the salary bands for each "Grade" of each department and each entity for 2001 and 2002.</p> <p>C. Please provide a description of each "Job Code". If individual digits of the "Job Code" have a specific meaning (e.g., 1XXX = Accounting, 2XXX = Human Resources, etc.), please provide this also.</p> <p><i>1/10/03--Complete--Received data for Parts A and C. Part B was not specifically addressed. Overland will consider non-response to mean that the salary bands are consistent.</i></p>	21

Resp.	Dr No.	Date Sent	Date Received	Description	Elapsed Days
C	OC 127	12/20/02	1/8/03	Affiliate / Dividend Policies Please describe the dividend policy (or policies concerning the return of capital, return of excess cash, etc.) of each South Jersey Gas affiliate, including Millenium Account Services for 2000, 2001, and 2002. This should include on what basis the amount of the dividend is determined, the frequency, the authorizing person or body, etc. <i>1/8/03--Complete pending review--Received a very brief description of SJI's dividend policy (at the corporate level). Information regarding the cash returned to SJI from Millennium is also provided. Need to review to determine if enough detail regarding the dividend policy has been provided.</i>	19
NR	OC 128	12/20/02		Internal Audit / Descriptions The descriptions of the internal audits does not appear consistent between responses to OC-23 and OC-24. A. For each internal audit listed in response to OC-23, indicate the internal audit description used in response to OC-24. B. If not already provided in response to other DR's, please provide copies of all internal audits performed or reported in 2000, 2001, or 2002 whose primary focus was on any of the following entities: the Appliance Service Business, Millenium Account Services, South Jersey Energy Company, South Jersey Resources Group, or Marina Energy. <i>1/13/03--Non-responsive--Answers to Part A are not adequately cross-referenced.</i>	83
C	OC 129	12/20/02	1/10/03	Utility / "Shopping Credit" and "Price to Compare" Please provide a summary of the individual components of the South Jersey Gas' "shopping credit" or "price to compare" in effect at any time in 2000, 2001, or 2002. Please provide a brief description of any acronyms used in the summary OR indicate where definitions can be quickly located (e.g. tariff on internet site, etc.). <i>1/10/03--Complete pending review--Received pages of SJG's tariff covering the Company's "price to compare."</i>	21
C	OC 130	12/20/02	12/27/02	Affiliate / SJI Corporate Guarantees Occasionally, Board of Directors' meeting minutes included exhibits entitled "Corporate Guarantees by South Jersey Industries, Inc.". Please provide a copy of all such schedules prepared (or schedules that are substantially similar in nature) from January 1, 2001 to present (December 20, 2002). <i>12/27/02--Complete pending review--Received schedules dated 1/19/01, 1/10/02, and 12/23/02.</i>	7

Resp.	Dr No.	Date Sent	Date Received	Description	Elapsed Days
C	OC 131	12/20/02	12/27/02	Affiliate / Corporate Guarantee Language Please provide examples of the standard South Jersey Industries, Inc. corporate guarantee language used during 2001 and 2002. (According to Rick Walker, the language was similar from transaction to transaction.) <i>12/27/02--Complete pending review--Received a copy of the standard corporate guarantee language.</i>	7
C	OC 132	12/20/02	1/10/03	Affiliate / Service Contracts As discussed in the interview with Mike Renna on December 17, 2002, Mr. Renna indicated that certain departments within South Jersey Gas and South Jersey Industries are developing service contracts. A. To the extent any of these service contracts are complete, please provide copies of all such contracts that were in effect during 2001 and 2002. B. If differences exist between the pricing described in these service contracts and the manner in which costs are allocated and/or billed per the CAM, please explain which takes precedence. <i>1/10/03--Complete--Received a response indicating that the agreements are not contracted documents and no cost allocations are in the agreements.</i>	21
C	OC 133	12/20/02	1/10/03	Affiliate / SJE SJRG / Invoices Between Please provide copies of all affiliate invoices from South Jersey Energy Company to South Jersey Resources Group and vice versa from January 1, 2001 to present (December 20, 2002). <i>1/10/03--Complete pending review--Received copies of invoices between SJE and SJRG.</i>	21
C	OC 134	12/20/02	1/10/03	Utility / Hedging Program As discussed in the interview with Jeff DuBois on December 18, 2002: A. Please provide the 10-year "design day" forecast which lists the supply contracts which will be used to meet the "design day" requirements. B. Please provide a copy of the most recent South Jersey Gas Company Hedging Program ("portfolio optimization") that has been submitted to the NJBPU for approval. (If there are any questions concerning this data request, please contact Bob Welchlin immediately.) <i>1/10/03--Complete pending review--Received answers to Parts A and B.</i>	21

Resp.	Dr No.	Date Sent	Date Received	Description	Elapsed Days
C	OC 135	12/31/02	1/10/03	Fin Data / Off-Balance Sheet Items Please provide a list of off-balance sheet (unconsolidated) assets, interests, liabilities or relationships, including assets, interests, or liabilities held by or business or financial activities conducted by special purpose entities, joint ventures, limited liability corporations (LLCs) or partnerships (LLPs) for which SJI or any of its subsidiaries have financial exposure or potential financial exposure. <i>1/10/03--Complete pending review--Received a "list" of off-balance sheet items. The answer provided the section of the SJI 2001 annual report related to SJI's exposure to MSI.</i>	10
C	OC 136	1/3/03	1/10/03	Affiliate / Millennium / BPU Presentation Material Please provide any written presentation materials used in the 1999 meeting(s) with Herb Tate, former Chairman of BPU, regarding the formation of Millennium Account Services. <i>1/10/03--Complete--Received direct testimony filed with the BPU in which Millennium was discussed.</i>	7
C/NR	OC 137	1/10/03	1/29/03	Accounting / Cost Allocation / Follow-up Questions Please complete the "affiliate allocation breakdown" spreadsheets for 2001 and 2002 that were sent to Tom Kavanaugh via e-mail on 1/10/03. As a part of providing the breakdown of allocated costs by affiliate, please provide the supporting documentation used to populate the spreadsheets. This could include 1) SJI providing new support not given in response to prior data requests or 2) SJI including detailed references (for each component of the spreadsheets) to OC numbers already provided by the Company. <i>1/29/03--Complete/Non-responsive--Received response stating that the Company can not produce the requested allocation breakdown by affiliate within the requested time due to system and time constraints.</i>	19

Resp.	Dr No.	Date Sent	Date Received	Description	Elapsed Days
P	OC 138	1/13/03		<p>Affiliate / ASB / Follow-up</p> <p>Referencing the responses to OC-25 and OC-65:</p> <p>OC-25: A review of the data in the "Job Title" column indicates that 65 employees have "App", "Appliance", or "AST" as part of the description in their job titles.</p> <p>1. If these are all Appliance Service Business (ASB) employees, please reconcile this headcount with the organization chart provided in response to OC-13 and the interview with Bob Fatzinger (see No. 5).</p> <p>2. If these are not all ASB employees, please indicate which employees are not ASB employees and identify for which company they work.</p> <p>OC-65: A review of the "Monthly Report by Service - Person" appears to indicate that there are over 90 different employees who performed ASB work in December 1999.</p> <p>3. If these are all Appliance Service Business (ASB) employees, please reconcile this headcount with the organization chart provided in response to OC-13 and the interview with Bob Fatzinger (see No. 5).</p> <p>4. If these are not all ASB employees, please identify which ones are not and reconcile with the comment from Mr. Fatzinger in his interview that ". . . there are only a limited number of utility techs that can do appliance service business." (see No. 8)</p> <p>1/29/03--Partial--Received response addressing Parts 1, 3, and 4. Part 2 asks for identification of which company non-appliance employees work for. Response indicates that not all employees are appliance employees but does not provide which companies those non-appliance employees work for.</p>	59
C	OC 139	1/13/03	1/30/03	<p>Affiliate / ASB / Follow-up</p> <p>How many full-time equivalent (FTE) employees did the Appliance Service Business (ASB) have in 2001 and the first nine months of 2002? Please quantify the amounts by year and by position (e.g., AST, CSR, etc.) and show any underlying calculations (e.g., XX Full Time Employees, XX% Part Time Employees, etc.).</p> <p>(Note: If utility techs performed work for the ASB in either year, please provide an FTE calculation for these employees also.)</p> <p>1/30/03--Complete pending review--Received response providing full-time equivalent information.</p>	17

Resp.	Dr No.	Date Sent	Date Received	Description	Elapsed Days
C	OC 140	1/13/03	1/29/03	Affiliate / ASB / Follow-up Please quantify the amount of repair parts expense charged to the Appliance Service Business as "Direct Expenses" (A/C's 879.1-879.88) for the following two time periods: 1. The year ended December 31, 2001 2. The nine months ended September 30, 2002. <i>1/29/03--Complete pending review--Received repair part expense information for 2001 and 2002.</i>	16
P	OC 141	1/13/03		Fin Data / Time Sheet / Follow-up Referencing the interview with Sharon Pennington on December 12, 2002: Ms. Pennington stated that her time is charged on an exception time basis (e.g., if she does not indicate that she has worked on a specific affiliate, all of her time will be charged to SJG). 1. For each major shared services function, please indicate whether or not employees used exception or positive time reporting during the time period from January 2001 to September 2002. If different methods were used during different time periods, please so indicate. The shared services functions should include, but not be limited to: Human Resources Information Services External Relations Materials / Facilities Finance Rates and Regulatory Affairs Accounting Marketing Customer Service (including CCC) Executive Other Significant Functions (please list) 2. In addition, to eliminate any confusion, please identify the departmental head of each of the shared services functions listed in response to 1 above. <i>1/30/03--Partial--Recieved non-responsive answer to Part 1. No indication of whether positive or exception time reporting is used was provided. Part 2 was answered.</i>	59
Average Elapsed Day					45